Supreme Court, U.S.
FILED
AUG 15 2006
OFFICE OF THE CLERK

No. 06-231

IN THE

Supreme Court of the United States

CITIZENS FINANCIAL SERVICES, FSB (FORMERLY KNOWN AS CITIZENS FEDERAL SAVINGS AND LOAN ASSOCIATION), PETITIONER

v.

UNITED STATES

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FEDERAL CIRCUIT

PETITION FOR WRIT OF CERTIORARI

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QUESTION PRESENTED

Where this Court has clearly held that special rules not applicable to private contracts may not determine government liability, *United States v. Winstar Corp.*, 518 U.S. 839 (1996), and that special rules may not deny damages for that liability, *Mobil Oil Exploration & Producing Southeast, Inc. v. United States*, 530 U.S. 604 (2000), did the courts below err in applying a special rule to limit a subset of damages for lost profits – contrary to decisions of this Court, the Federal Circuit itself, other courts of appeals, state courts, the *Restatement* and leading treatises – to proof of "specific" lost opportunities?

RULE 29.6

Pursuant to this Court's Rule 29.6, petitioner states that Citizens Financial Services, FSB (now known as Citizens Financial Bank) is a wholly owned subsidiary of CFS Bancorp, Inc., a publicly traded corporation. No other publicly traded company owns 10 percent or more of Citizens' stock.

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PETITION FOR A WRIT OF CERTIORARI

Petitioner, Citizens Financial Services, FSB ("Citizens"), respectfully submits this petition for a writ of certiorari to review the judgment of the United States Court of Appeals for the Federal Circuit.

OPINIONS BELOW

The opinion of the court of appeals is not officially reported but appears in the Appendix of this Petition ("App.") at 1a. The order of the court of appeals denying rehearing and rehearing *en banc* is not officially reported but appears at App. 2a-3a. The opinion of the trial court on lost profits damages is published at 64 Fed. Cl. 498 (2005) and appears at App. 4a-47a; and its summary judgment opinion on remedies is published at 59 Fed. Cl. 27 (2003), and appears at App. 48a-71a. The opinion of the trial court on liability is not officially reported but appears at App. 48a-71a.

JURISDICTION

The judgment of the court of appeals was entered on March 9, 2006. App. 1a. Petitioner's timely petitions for rehearing and rehearing *en banc* were denied on May 17, 2006. App. 2a-3a. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

RELEVANT PROVISIONS INVOLVED

This petition presents questions under the federal common law of contracts.

STATEMENT

In 1983, Citizens agreed to acquire two failing thrifts to assume $40.15 million in net liabilities in exchange for the government's promise to allow Citizens to include $52.9 million in supervisory goodwill arising out of the acquisitions in calculating its regulatory capital and $12.75 million in cash assistance. In 1989, the government breached its goodwill promise by enacting and enforcing the Financial Institutions Reform, Recovery, and Enforcement Act, Pub. L. 101-73, 103 Stat. 183 ("FIRREA"). *United States v. Winstar Corp.*, 518 U.S. 839 (1996).

The government's breach immediately eliminated $30.5 million of Citizens' capital -- more than 50% of its existing capital -- and eliminated another $8 million by 1994, or a total of 70% of its capital. After FIRREA, the government's regulators deemed Citizens' capital "marginal," requiring Citizens to increase its capital ratios.

The government's massive breach and regulatory pressure forced Citizens-- a conservative and profitable thrift -- to abandon its growth plans and drastically alter its strategy. App. 50a. Citizens reduced its asset size in 1989 and followed a "no growth" policy for years until it restored its capital levels in 1993 through its retained earnings. The government's enormous capital breach caused Citizens to suffer substantial lost profits by having fewer earning assets through 1993 and beyond than it otherwise would, while its unaffected peers grew and expanded.

At trial, Citizens claimed lost profits damages. The trial court denied Citizens' any damages, and the Federal Circuit summarily affirmed. The decisions

below ignored settled damages law and conflict with decisions of this and other courts, in denying a proper claim for lost profits damages because Citizens did not show "specific" lost opportunities, thereby relieving the government of financial responsibility for its adjudicated breach of contract in this case.

1. This case arises from the thrift crisis of the 1980s, which previously has been chronicled by this Court in *Winstar*, 518 U.S. at 844-48. Between 1981 and 1983 alone, some 435 thrifts failed. *Id.* at 845. These failing thrifts left the Federal Savings and Loan Insurance Corporation ("FSLIC") itself insolvent; the costs of liquidating the thrifts would have swamped FSLIC's reserves by a factor of three. *Id.* at 847. "Realizing that FSLIC lacked the funds to liquidate all of the failing thrifts, the [Federal Home Loan Bank Board (FHLBB)] chose to avoid the insurance liability by encouraging healthy thrifts and outside investors to take over ailing institutions in a series of 'supervisory mergers.'" *Id.*

As this Court has explained, "[s]uch transactions, in which the acquiring parties assumes the obligations of thrifts with liabilities that far outstripped their assets, were not intrinsically attractive to healthy institutions; nor did FSLIC have sufficient cash to promote such acquisitions through direct subsidies alone, although such cash contributions from FSLIC were often part of a transaction." *Winstar*, 518 U.S. at 848. Accordingly, to attract outside investors, FSLIC made regulatory commitments to potential acquirers—commitments that functioned as "cash substitute[s]" in the context of supervisory mergers. *Id.* at 850.

In most supervisory mergers, the government contractually agreed to permit the acquiring

institutions to count the massive net liabilities assumed in the mergers as "supervisory goodwill," which could be considered an asset in meeting the regulatory capital requirement. *Id.* at 846-50; *see also id.* at 921 (Scalia, J., concurring)(goodwill promises were "*sine qua non*" of supervisory mergers). This treatment "would help the acquiring institutions meet their reserve capital requirements imposed by federal regulations" and was the "principal inducement" for these otherwise costly supervisory mergers. *Id.* at 848. As this Court recognized, the use of supervisory goodwill increased "the institution's reserves, thereby allowing the thrift to leverage more loans (and, it hoped, make more profits)." *Id.* at 851; *see also id.* at 924 (Scalia, J., concurring)(observing leverage capacity was "essential bargain" of contract).

2. In 1989, Congress passed FIRREA, which made significant changes in the structure of federal thrift regulation. *Winstar*, 518 U.S. at 856. FIRREA also vitiated the crucial feature of the supervisory merger agreements that the governments had used to escape the savings and loan crisis. FIRREA imposed minimum capital requirements and eliminated the use of supervisory goodwill over a five-year period, far more quickly than the 35-40 years promised in supervisory agreements. *Id.* at 857.

Winstar established that FIRREA's new regulatory capital breached the contractual supervisory merger agreements by withdrawing their essential consideration. 518 U.S. at 870. This Court recognized that these agreements were a great benefit to the government and a great burden to the acquiring thrifts, with goodwill promises as the banks' principal compensation. *Id.* at 886-87, 869, 906, 908; *id.* at 918 (Breyer, J., concurring); *id.* at 919 (Scalia, J.,

concurring). Finding the government liable for the breach caused by FIRREA, this Court remanded the case for proceedings on the "appropriate measure or amount of damages." *Id.* at 910.

3. In 1983, Citizens agreed to acquire, and thereby to assume the substantial net liabilities of two failed thrifts. The supervisory merger agreements with the government were materially indistinguishable from those in *Winstar*. In exchange for assuming the two thrifts' net liabilities in excess of $52.9 million, the government allowed Citizens to count $52.9 million as supervisory goodwill and thereby regulatory capital. App. 49a. Also as in *Winstar*, the government allowed Citizens to amortize the goodwill capital over a period of 35 years. *Id.* The agreement relieved the government of its insurance liability for the failed thrifts, a liability that would have cost hundreds of millions of dollars in liquidating the thrifts. The government thus "convert[ed] some of its financial insurance obligations into responsibilities of private entrepreneurs." *Winstar*, 518 U.S. at 894.

In 1989, FIRREA immediately eliminated $30.5 million in supervisory capital, more than 50% of Citizens' $57 million in total capital, and phased-out another $8 million through 1994, or 70% of Citizens' capital overall. As this Court recognized, the effects of FIRREA on an acquiring institution, such as Citizens, were "swift and severe." *Winstar*, 518 U.S. at 587. FIRREA's breach had a massive impact on Citizens. Overnight, the breach destroyed the valuable capital cushion of a responsible and well-managed thrift that had taken years to build, placing Citizens on the brink of being out of capital compliance, and forcing the thrift to abandon its normal internal expansion plans, as well as its more ambitious external expansion plans.

4. Like others, Citizens sued the government for breach of contract. App. 72a. After this Court ruled in *Winstar* that the government could be held liable for FIRREA-related breaches of contract, the Court of Federal Claims granted summary judgment to Citizens on liability. App. 72a.

At trial, Citizens claimed lost profits damages, showing the government's massive breach caused this profitable thrift to shrink in 1989 and forgo subsequent growth, resulting in Citizens being far smaller, with far fewer earning assets and profits. *See Glendale Fed. Bank v. United States*, 239 F.3d 1374, 1380 (Fed. Cir. 2001)(lost profits are primary means by which "the law makes the non-breaching party whole").

Citizens was a traditional thrift that consistently earned profits on its assets both before and after FIRREA, with its average pre-tax returns on assets above 1.1%, comparable to the peer group developed by the government's expert. *See* J.A., *Citizens Fin'l Servs., FSB v. United States*, No. 05-5116 (Fed. Cir. filed Nov. 7, 2005), at A102328, 32, 61; A103513; A104112-13, 4129-31; A201988; A202017; A202024; A300091.

Indisputably, Citizens grew its tangible assets 5% in 1987, and 5.3% in 1988. *Id.* at A101708-10; A201999; A202000; A300035. Citizens' pre-FIRREA business plans anticipated continuing growth by at least that same 5% rate in the next three years. *Id.* at A101732-42; A200687; A201841. Directly as a result of the government's about-face, Citizens was forced to reverse course and adopted a "no growth" strategy that it followed through mid-1993, as was well documented. *Id.* at A101769-73, 1776-81.

The breach had a staggering impact on Citizens by taking away $38.5 million or 70% of its then-existing

regulatory capital. *Id.* at A000232-33; A201639; A201984. The FDIC deemed Citizens' remaining capital "marginal." *Id.* at A101322; A200245-46.

In 1989 due to the breach, Citizens reduced its tangible assets by approximat ly $9 million, or 1.4%. *Id.* at A201999; A202016. Citizens had virtually no growth for four years through mid-1993. *Id.* at A201992; A201999-2000. During the same post-breach period, Citizens' local competitors grew their deposits at a compound annual rate of 7.64% while Citizens barely grew by a nominal .25%. *Id.* at A100139-141, 558-559; A102248; A200305; A201969; A201997. Even the government's expert's peer group demonstrated 5% growth during the post-breach period. *Id.* at A103504, 31; A300034-35. After 1993, the thrift finally began to grow again, reaching $597 million, $646 million and $746 million in assets in 1995, 1996 and 1997, respectively. *Id.* at A201981; A201991.

At trial, Citizens quantified its lost profits damages by establishing: (1) how much larger Citizens would have been absent the breach; and (2) what amount of profits would have been earned on its incremental assets. Citizens showed, at a minimum, that it would have had a growth rate consistent with or even below, its pre-breach performance and plans and actual peer growth of 5% until 1993 and thereafter at its actual, faster rate, resulting in lost profits of $10.3 million based on its historical 1.1% return on assets.[1]

Following trial, the trial court below failed to make any findings that the breach did not cause

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[1] Citizens alternatively presented evidence that, absent the government's breach, it would have grown to the extent permitted by its pre-breach 10% capital ratio and goal, amounting to lost profits of $20.9 million.

Citizens to forgo growth commensurate with its pre-breach performance and plans, the performance of its peers, or its performance after 1993. Indeed, the trial court never made any findings that the breach caused Citizens ***no*** damages. Instead, the trial court made two other findings. First, the trial court made the nondispositive finding that Citizens failed to prove it had a 10% capital goal that applied *only* to its other $20.9 million growth analysis. App. 17a-22a. Second, the trial court, applying a single arbitrary standard, made the finding that "capital concerns did not prevent [Citizens] from pursuing any ***specific*** investment opportunities" after FIRREA. App. 23a-29a (emphasis added). In doing so, the trial court failed to make relevant findings under uniformly acknowledged principals of contract and damages law and, thereby, eviscerated this Court's direction in *Winstar* that mandated their application.

While this Court held that the government "agreed to pay damages in the event [its breach] caused financial injury," *Winstar*, 518 U.S. at 871, the trial court's decision awarding Citizens no damages relieved the government of this obligation in a case where damages were obvious. App. 4a-50a.

The Federal Circuit's summary affirmance of the trial court's denial of lost profits erred in failing to apply long-standing precedent of this Court and other settled authority recognizing and allowing recovery of the very type of lost profits claimed and shown in this case. App. 1a.

Contrary to the holding at trial, and uncorrected below, Citizens, as a successful, plain vanilla thrift was prevented from expanding its existing business of making single family mortgages and buying mortgage-related securities, was not required to prove "specific

investment opportunities" to establish lost profits. Instead, under controlling precedent, Citizens was entitled to prove its lost profits by its pre-breach performance, or post-breach performance, or peer or industry performance. The only way to avoid the conclusion that Citizens did not lose profits in this case was to avoid the analysis entirely, as the courts did below, in erecting a special rule limiting the recovery of lost profits damages.

REASONS FOR GRANTING THE PETITION

The trial decision and the Federal Circuit's summary affirmance fundamentally misapprehend or disregard basic damages law principles established by this and other courts, which uniformly allow lost profits upon proof of pre-breach performance, or post-breach performance, or peer or industry performance, and do not require, as did the courts below, a showing of "specific" lost opportunities as the sole and exclusive basis for recovery of lost profits.

In *Winstar*, there was no conflict among the courts of appeals. Instead, the Court granted certiorari "to consider the extent to which special rules, not generally applicable to private contracts, govern enforcement of the governmental contracts at issue here." 518 U.S. at 860. In *Winstar*, this Court held that the government could not rely on such special rules on *liability*, and in *Mobil Oil* extended that principle to contract *damages*. Certiorari is required to further clarify that special rules are not to be applied to a subset of damages, for lost profits.

Unless corrected by this Court, the decisions below, representative of decisions of the Federal Circuit generally that limit recourse for the liability

found by this Court in *Winstar*, could have profound consequences for the next time emergency assistance from industry is sought by the government.

I. THE DECISIONS BELOW ARE CONTRARY TO PRINCIPLES OF DAMAGES LAW LONG ESTABLISHED BY THIS AND OTHER COURTS THAT LOST PROFITS MAY BE PROVED EITHER BY PRE-BREACH, POST-BREACH, OR PEER PERFORMANCE

As long held by this Court and other circuits, a plaintiff may recover lost profits under ***any*** of the following standards: (1) a "before and after" comparison; ***or*** (2) a "yardstick" comparison to peers or industry averages; ***or*** (3) the loss of specific business or customers.[2]

For example, in a market exclusion case seeking lost profits, a plaintiff may produce evidence falling into any one of the following categories: (1) comparison of performance before and after the wrongful conduct under otherwise similar conditions; *see, e.g., Bigelow v. RKO Radio Pictures, Inc.*, 327 U.S. 251 (1946); *Eastman Kodak Co. v. Southern Photo Co.*, 273 U.S. 359, 376-78 (1927); (2) comparison of performance in restrained and unrestrained markets which are otherwise comparable; *see, e.g., Zenith Radio Corp. v. Hazeltine Research, Inc.*, 395 U.S. 100, 116 n.11, 123-25 (1927); *Bigelow, supra*; or (3) loss of specific business or customers, *see, e.g., Herman Schwabe, Inc. v. United Shoe Machinery Corp.*, 297 F.2d 906, 913 (2d Cir. 1962).

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[2] As discussed below, the third category of "loss of *specific* opportunities" is a permissible standard for lost profits, not the exclusive method.

During pretrial, the trial court appeared to recognize these basic principles in denying the government's motion for summary judgment on lost profits, stating:

> The court agrees with Citizens that the government is not entitled to summary judgment on the issue of lost profits. Contrary to the government's assertions, Citizens has identified evidence to show that the government's breach interrupted Citizens' plans to expand its traditional thrift business of raising retail deposits and investing in safe, mortgage-type assets and investment securities. Citizens' pre-FIRREA business plans indicated that it intended to increase growth of both assets and deposits. Citizens' business plans following enactment of FIRREA show that Citizens embarked on a program to rebuild its capital by foregoing deposit growth.

App. 67a.

At trial, however, the court failed not only to apply, but even discuss the contract principles and evidentiary basis upon which it denied summary judgment. Instead, the court formulated other issues for resolution: "whether Citizens' decision to forgo growth for several years was related to FIRREA" and "whether Citizens had to forgo any *specific* profitable opportunities because of FIRREA," App. 8a-9a (emphasis added). Yet it made no findings under the former, to determine whether the breach caused Citizens to forego growth, in terms of the relevant evidence of Citizens' pre-breach growth, contemporaneous business plans, post-1993 growth, or

peer growth. Instead, the court focused only upon the loss of "specific" investment opportunities in order to prove any lost profits, the irrelevance of which is discussed in Point II, *infra*.[3]

In so doing, the trial court, and the Federal Circuit in never questioning the opinion below, deviated from basic contract damages law and decisions of this Court that were directly applicable to Citizens' lost profits claim.

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[3] The trial court repeatedly tied its findings that Citizens did not prove lost profits to an ostensible failure to prove "specific" lost opportunities: (1) RTC thrift acquisitions, App. 24a-26a; (2) the reduction in fixed-rate mortgages, App. 26a-27a; (3) trust operations or securities brokerage, App. 27a; or (4) "any '***specific*** growth opportunties' that Citizens had to forgo because of FIRREA." App. 26a, 30a. In sum, the trial court concluded that "Citizens did not grow or pursue various business opportunities immediately following FIRREA because Citizens did not believe that those opportunities would be profitable or worth the risk," App. 31a, otherwise Citizens could have raised capital if it had "sufficiently profitable opportunities." App. 28a. (emphasis supplied)

In alternatively rejecting Citizens' claim on reasonable certainty grounds, the trial court similarly focused exclusively on "specific" opportunities, while ignoring Citizens' overwhelming evidence satisfying generally applicable contract standards: (1) "The limited evidence the court received regarding mortgage-backed securities did not provide the court with a level of certainty regarding the availability of ***specific*** securities that would have yielded Citizens a profit. . . ." App. 34a-35a; (2) "The court did not receive any evidence to show what ***specific*** investments could have been made and what the yields would have been," App. 35a; and (3) "Professor Horvitz could not identify with any ***specificity*** which investments, whether mortgage-backed securities or other assets, would have guaranteed Citizens the 1.1% rate..." App. 38a. (emphasis supplied)

A. "Nothing Is More Indicative" Of Lost Profits, As This Court Has Ruled, Than Pre-Breach Performance

As this Court declared long ago in *Palmer v. Connecticut Railway & Lightning Co.*, 311 U.S. 544 (1941): "The proof of future profits by the evidence of past profits in an established business gives a reasonable basis for a conclusion. . . . Nothing is more indicative . . . than past earnings." *Id.* at 559-60. A plaintiff's evidence of past earnings is "a fair base to use to project the estimate of the earnings [from] future operation[s]" *standing alone*, with other evidence, either through experts or otherwise, simply unnecessary. *Id.* at 561-62. As similarly held by this Court in *Eastman Kodak*, a plaintiff's experience of past four years is sufficient as the *sole* basis for recovery lost profits. 273 U.S. at 379.

Indeed, as generally recognized by the leading treatise on lost profits: "Perhaps the best evidence of lost profits is a comparison of the experience of plaintiff's own business before and after the interruption of its progress by the wrongful act of defendant." 1 Robert L. Dunn, Recovery of Damages for Lost Profits §5.7 (5th ed. 1998) (citing cases). This principle is universally recognized in the *Restatement* and treatises, RESTATEMENT (SECOND) OF CONTRACTS § 352 cmt. b & illus. 5 ("Evidence of past performance will form the basis for a reasonable basis for the future."); 11-56 CORBIN ON CONTRACTS § 1023; 3 Dan B. Dobbs, DOBBS LAW OF REMEDIES §12.4(3) at 71-74 (1993); 24 Richard A. Lord, WILLISTON ON CONTRACTS § 64:11, at 115 (4th ed. 2002); 3 FARNSWORTH ON CONTRACTS § 12.15 at 270-71 (2d ed. 1998), and uniformly applied in other circuits. *See, e.g., C.A. May*

Marine Supply Co. v. Brunswick Corp., 649 F.2d 1049, 1053-4054 (5th Cir. 1981)(classic "before and after" and "yardstick" lost profits measurements); *G.M. Brod & Co., Inc. v. U.S. Home Corp.*, 759 F.2d 1526, 1538-39 (11th Cir. 1985)(same); *Frito-Lay, Inc. v. Local Union No. 137*, 623 F.2d 1354, 1363-64 (9th Cir. 1980).

Contrary to all of this authority, the courts below failed to consider Citizens' pre-breach history of 5% growth and steady profits to find that, at a minimum, it would have continued expanding its business by that same rate, for which it was entitled to lost profits damages.

B. The Courts "May Not Neglect," As This Court Also Has Ruled, Post-Breach Performance In Deciding Lost Profits

This Court also has made clear long ago that the courts "may not neglect" the "book of wisdom" of post-injury evidence in evaluating damages. *Sinclair Refining Co. v. Jenkins Petroleum Process Co.*, 289 U.S. 689, 697-98 (1933). Yet, the courts below did just that by entirely ignoring overwhelming evidence of Citizens' post-1993 growth and profitability.

Other circuits follow the general rule that a comparison of growth rates before the injury and after the wrongdoing is sufficient to show that a plaintiff would have grown at the pre-injury rate had the wrongdoing not occurred. *See Lewis v. Mobil Oil Corp.*, 438 F.2d 500, 511 (8th Cir. 1971).

This Court recognized in *Winstar* that the government's goodwill promises "allowed the thrift to leverage more loans (and, it hoped, make more profits)." *Winstar*, 518 U.S. at 851. The Federal Circuit, in *Cal. Fed. Bank v. United States*, 245 F.3d

1342 (2001), held that it is a "correct[] observ[ation]" that the government "knew that breaching this agreement would cause [a thrift] to adjust its capital ratio. That is, it knew that [a thrift] would have to reduce its assets or increase its capital." *Id.* at 1350. Therefore, a permissible method is to project lost profits from lost supervisory goodwill that the thrift actually experienced from operations with other capital during the damages period. This is a well-recognized approach to proving lost profits damages for a plaintiff with a history of profitable operations impacted by a breach of contract.

The courts below failed to apply or ignored this alternative standard and thus overlooked that Citizens grew by more than 5% during the two years preceding the breach, then shrunk in 1989, and had virtually no growth until mid-1993 when it resumed normal growth after restoring its capital position through retained earnings.

C. "The Great Weight of Authority," As Generally Recognized, Also Determines Lost Profits By Peer Performance

"The great weight of authority is that evidence of another's experience in operating a comparable business is admissible to prove lost profits damages." 1 Dunn, §§ 5.12, 5.16 (citing cases).

This Court has long recognized in *Zenith Radio* that a comparison between a plaintiff's operation in an injury-free market and a second market where the injury occurred is sufficient to establish lost profits damages. 395 U.S. at 116 n.11, 123-25. Other circuits and state courts have similarly held that peer comparisons and industry averages are sufficient to

prove lost profits. *See, e.g., Southern Pines Chrysler-Plymouth, Inc. v. Chrysler Corp.*, 826 F.2d 1360, 1364 (4th Cir. 1987)(yardstick comparison of auto dealer to manufacturer); *R.K. Chevrolet, Inc. v. Hayden*, 480 S.E.2d 477, 482 (Va. 1997)(comparing auto dealer to others in same area and industry averages); *Tuscon Fed. S&L Ass'n v. Aetna Inv. Corp.*, 245 P.2d 426, 429 (Ariz. 1952) (average net insurance commissions earned on gross premiums).

Despite even the government's own peer group showing 5% growth and 1% profitability, the courts below further overlooked or disregarded this additional settled basis for awarding lost profits damages.

As to all three of the foregoing alternative settled bases for proving lost profits, the courts below failed to apply fundamental principles applicable to private parties to the government's breach of contract as found by this Court, in denying Citizens ***any*** lost profits.

II. THE DECISIONS BELOW TO APPLY A SPECIAL RULE RECOGNIZING ONLY "SPECIFIC" LOST OPPORTUNITES AS A BASIS FOR LOST PROFITS ARE CONTRARY TO LONG-STANDING DECISIONS OF THIS AND OTHER COURTS

A. The Decisions Below Are Contrary To Principles Established By Decisions Of This Court

This Court recently has twice made crystal clear: "'When the United States enters into contract relations, its rights and duties therein are governed generally by the law applicable to contracts between

private parties.'" *Mobil Oil Exploration & Producing Southeast, Inc. v. United States*, 530 U.S. 604, 607 (2000)(quoting *United States v. Winstar Corp.*, 518 U.S. 839, 895 (1996)(plurality opinion)). Put another way, when the government contracts with private parties, enforcement of those contracts is not governed by "special rules, not generally applicable to private contracts." *Winstar*, 518 U.S. at 860; *see also id.* at 895 & n.39. This principle applies equally to the availability and application of damages remedies. *See Mobil Oil, supra; Priebe & Sons, Inc. v. United States*. 332 U.S. 407, 411 (1947).

As this Court has also previously made crystalline: "The ways compensatory damages may be proven are many. The injured party is not to be barred from a fair recovery by impossible requirements. The wrongdoer should not be mulcted, neither should he be permitted to escape under cover of a demand for nonexistent certainty." *Palmer v. Conn. Railway & Lighting Co.*, 311 U.S. 544, 560-61 (1941).

Yet the decisions below, by special rule protective of the government, permitted Citizens only to seek to demonstrate "specific" investments that it was forced to forego as a result of the government's breach, irrelevant to these facts, instead of permitting Citizens to prove its lost profits by other bases long universally recognized, whether by pre-breach, post-breach, or peer performance.

In *Winstar*, this Court held that the government "agreed to pay damages in the event [its breach] caused financial injury." 518 U.S. at 871. In this case, it is undisputed that the government's breach of its promise caused a massive 70% reduction in Citizens' valuable capital. Yet, the trial court below awarded Citizens no damages, relieving the government of its obligation in a

case where damages were obvious. App. 4a-71a. Likewise, the Federal Circuit, by summary affirmance and despite firmly established precedent requiring an award of lost profits in these circumstances, held Citizens, a victim of wrongdoing established by this Court in *Winstar*, to be remediless. App. 1a.

In stating "The Federal Circuit has stressed that plaintiffs face a *heavy burden* in proving lost profits in Winstar cases," the trial court wrongly held that Citizens was required to meet a higher standard of proof because it sought to collect damages from the government, as opposed to a private litigant, in conflict with two recent holdings otherwise by this Court. App. 11a (emphasis added); J.A., *supra*, at A103401-02 (Court)("you're asking the people of the United States to pay you $20 million on the grounds that I was harmed by what the Government did to me."). The trial court's assumption that "proving lost profits is often a hopeless endeavor" in *Winstar* cases because the Federal Circuit has stated in *dicta* that they are "not susceptible to reasonable proof," "speculative," and "a waste of time" App. 11a (citing *Glendale*, 378 F.3d at 1313) is thus contrary to basic contract principles, controlling law, and public policy. Where, as here, the sovereign has waived immunity, the courts may not act "as a self-constituted guardian of the Treasury." *Indian Towing Co. v. United States*, 350 U.S. 61, 69 (1955).

As set forth in *Story Parchment Co. v. Paterson Parchment Paper Co.*, 282 U.S. 555 (1931):

> Where the tort itself is of such a nature as to preclude the ascertainment of the amount of damages with certainty, it would be a perversion of fundamental principles of justice to deny all relief to the injured person, and thereby relieve

the wrongdoer from making any amend for his acts. In such case, while the damages may not be determined by mere speculation or guess, it will be enough if the evidence show the extent of the damages as a matter of just and reasonable inference, although the result be only approximate. The wrongdoer is not entitled to complain that they cannot be measured with the exactness and precision that would be possible if the case, which he alone is responsible for making, were otherwise. *Eastman Kodak Co.* v. *Southern Photo Co.*, 273 U.S. 359, 379.

. . .

"*To deny the injured party the right to recover any actual damages in such cases, because they are of a nature which cannot be thus certainly measured,* would be to enable parties to profit by, and speculate upon, their own wrongs, encourage violence and invite depredation. *Such is not, and cannot be the law, though cases may be found where courts have laid down artificial and arbitrary rules which have produced such a result.*"

. . . There is no sound reason in such a case, as there may be, to some extent, in actions upon contract, for throwing *any part* of the loss upon the injured party, which the jury believe from the evidence he has sustained; though the precise amount cannot be ascertained by a fixed rule, but must be matter of opinion and probable estimate. *And the adoption of any arbitrary rule in such a case, which will relieve the wrong-doer from any part of the damages, and throw the loss*

> *upon the injured party, would be little less than legalized robbery.*
>
> "Whatever of uncertainty there may be in this mode of estimating damages, is an uncertainty caused by the defendant's own wrongful act; and justice and sound public policy alike require that he should bear the risk of the uncertainty thus produced; . . ."
>
> . . . [T]here are many cases in which damages are allowed where the element of uncertainty is at least equal to that in the present case -- as, for example, copyright and trade mark cases, cases of unfair competition, and many cases of personal injury. . . . Numerous decisions . . . support of the statement, that "*The constant tendency of the courts is to find some way in which damages can be awarded where a wrong has been done. Difficulty of ascertainment is no longer confused with right of recovery.*"

282 U.S. at 563-66 (emphasis added, citations omitted).

This Court has consistently held that too much reliance on certainty "'would enable the wrongdoer to profit by his wrongdoing at the expense of his victim. It would be an inducement to make wrongdoing so effective and complete in every case as to preclude any recovery, by rendering the measure of damages uncertain.'" *J. Truett Payne Co. v. Chrysler Motors Corp.*, 451 U.S. 557, 566 (1981) (quoting *Bigelow*, 327 U.S. at 264-65).

> Our willingness to accept a degree of uncertainty in these cases rests in part on the difficulty of

> ascertaining business damages as compared, for example, to damages resulting from a personal injury or from condemnation of . . . land. The vagaries of the marketplace usually deny us sure knowledge of what plaintiff's situation would have been in the absence of the defendant's antitrust violation. But our willingness also rests on the principle articulated in cases such as *Bigelow*, that it does not 'come with very good grace' for the wrongdoer to insist upon specific and certain proof of the injury which it has itself inflicted.

Id. at 566-67 (citations omitted).

These principles apply not only in the antitrust context, but in any case where "the element of uncertainty is at least equal to that in the present case," as explained in *Story Parchment*, 282 U.S. at 565, particularly when created by the wrongdoing itself.

No real distinction exists between an antitrust plaintiff denied market access who later attempts to show lost profits, and a *Winstar* plaintiff effectively denied use of goodwill capital to leverage existing growth. Indeed, as previously recognized by the Federal Circuit itself in reversing summary judgment in *Cal. Fed.*: "'If a reasonable probability of damage can be clearly established, uncertainty as to the amount will not preclude recovery.'" 245 F.3d at 1350 (quoting *Locke*, 283 F.2d at 524).

> Proof of the fact of damages in a lost profits case means proof that there would have been some profits. If plaintiff's proof leaves uncertain whether plaintiff would have made any profits at all, there can be no recovery. But once this level

> of causation has been established for the fact of damages, less certainty (perhaps none at all) is required in the proof of the amount of damages. While the proof of the fact of damages must be certain, proof of the amount can be an estimated, uncertain or inexact.

Mid-America Tablewares, Inc. v. Mogi Trading Co., Ltd., 100 F.3d 1353, 1367 (7th Cir. 1996)(quoting 1 Dunn, §1.3 at 11).

Here, in contravention of this Court's long precedent, the trial court did not make any findings as to the fact of damage. The court failed to reach such findings while focused on an artificial and arbitrary sole legal standard, concerning specific lost opportunities. While purporting not to find causation, which is "hardly a rigorous analytic tool,"[4] the trial court in effect conflated causation with reasonable certainty, citing other trial level decisions addressing lost profits claims that similarly combine causation with certainty, while focused on the latter and specific lost opportunities.[5]

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[4] *Blue Shield of Va. v. McCready*, 457 U.S. 465, 478, n.13 (1982) (observing "The traditional principle of proximate cause suggests the use of words such as 'remote,' 'tenuous,' 'fortuitous,' 'incidental,' or 'consequential' to describe those injuries that will find no remedy at law). And the use of such terms only emphasizes that the principle of proximate cause is hardly a rigorous analytic tool. *See, e. g., Palsgraf v. Long Island R. Co.*, 248 N.Y. 339, 351-52, 162 N.E. 99, 103 (1928) (Andrews, J., dissenting)("'What is a cause in a legal sense, still more what is a proximate cause, depend in each case upon many considerations. . . . What we do mean by the word 'proximate' is, that because of convenience, of public policy, of a rough sense of justice, the law arbitrarily declines to trace a series of events beyond a certain point").

[5] App. 38a-40a (discussing *Standard Fed. Bank v. United States*, 62 Fed. Cl. 265 (2004); *Southern Nat'l Corp. v. United States*, 57

In affirming the trial court, the Federal Circuit effectively erected a much higher standard of proof in establishing lost profits against the government than in disputes between private parties, creating a special rule beneficial to the government. In effect, after the government took away a devastating 70% of Citizens' valuable regulatory capital, the courts below withheld Citizens' obvious damages, rendering *Winstar* and the liability ruling in this case a "teasing illusion like a munificent bequest in a pauper's will," *Edwards v. California*, 314 U.S. 160, 186 (1941), reducing it to a dead letter.

B. The Decisions Below Are Inconsistent With Decisions Of The Federal Circuit Itself

This Court has previously granted review to resolve apparent conflicts within a circuit when it has deemed the question important. *Commissioner v. Estate of Bosch*, 387 U.S. 456, 457 (1967); *John Hancock Ins. Co. v. Bartels*, 308 U.S. 180, 181 (1939). This is particularly appropriate here, since the Federal Circuit has exclusive jurisdiction over all *Winstar* cases. *Cf. Maggio v. Zeitz*, 333 U.S. 56, 59-60 (1948) (granting certiorari to resolve intra-circuit conflict where one circuit was most often confronted with important bankruptcy issue).

Indeed, this Court has undertaken a special responsibility to review and to intervene in the Federal Circuit's administration of matters within its exclusive jurisdiction. Specifically, this Court has frequently granted review of cases with the Federal Circuit's

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Fed. Cl. 294 (2003); *Fifth Third Bank v. United States*, 55 Fed. Cl. 223 (2003)).

exclusive jurisdiction over breach of contract claims against the government, recognizing that a conflict among the circuits may never arise, where the Federal Circuit has departed from the accepted course. *See, e.g., Hercules, Inc. v. United States*, 516 U.S. 417 (1996)(resolving whether government contractor could recover tort judgments incurred in course of performing contract from government). Under such circumstances, this Court again has focused on the importance of the issue at stake in the case in determining whether review is warranted. *See* R. Stern, *et al.*, *Supreme Court Practice* § 4.21 at 264-65 (8th ed. 2002).

As long recognized by the Federal Circuit in other contexts, where the defendant, as here, "takes the position that the fact of damage as well as the amount . . . is too speculative to permit of proof . . . the constant tendency of the court is to find some way in which damages can be awarded where a wrong has been done." *Locke v. United States*, 283 F.2d 521, 524 (Cl. Ct.1960)(citing *Bigelow v. RKO Radio Pictures*, 327 U.S. 251, 265 (1946)).

> *The defendant who has wrongfully broken a contract should not be permitted to reap advantage from his own wrong by insisting on proof which by reason of his breach is unobtainable* . . . Any other rule would enable the wrongdoer to profit by his wrongdoing at the expense of his victim. It would be an inducement to make wrongdoing so effective and complete in every case as to preclude any recovery by rendering the measure of damages uncertain. Failure to apply [this rule] would mean that the more grievous the wrong done,

> the less likelihood there would be for recovery. *The most elementary conceptions of justice and public policy require that the wrongdoer shall bear the risk of the uncertainty which his own wrong has created.*

Locke, 283 F.2d at 524 (emphasis added; citations and internal quotations omitted).

Outside of the government contract arena and prior to *Winstar* cases, the Federal Circuit held that a comparison of growth rates before the injury and after the wrongdoing is sufficient to show that a plaintiff would have grown at the pre-injury rate had the wrongdoing not occurred. *Lam, Inc. v. Johns-Manville Corp.*, 718 F.2d 1056, 1068 (Fed. Cir. 1983); *see Chain Belt Co. v. United States*, 115 F. Supp. 701, 718-19 (Ct. Cl. 1953).

Due to the intra-circuit inconsistency in the Federal Circuit's rulings, petitioner asks, at a minimum, that this Court intervene for the purpose of returning this case to the Federal Circuit for *en banc* consideration. Where, as here, the lower appellate court's decision is inconsistent with its own precedents, the proper remedy is a grant, vacate, and remand ("GVR") order, by which the Court would grant the current petition, vacate the judgment below, and remand for further consideration by the Federal Circuit. *See Lawrence v. Chater*, 516 U.S. 163, 167 (1996). By returning the case to the Federal Circuit for review, the Court would accomplish all of the stated goals of a GVR order:

> a GVR order conserves the scarce resources of this Court that might otherwise be expended on plenary consideration, assists the court below by

> flagging a particular issue that it does not appear to have fully considered, assists this Court by procuring the benefit of the lower court's insight before we rule on the merits, and alleviates the "potential for unequal treatment" that is inherent in our inability to grant plenary review of all pending cases raising similar issues....

Id. at 167.

C. The Decisions Below Are Also Contrary To The Decisions Of Other Circuits

The courts below overlooked that the interruption of Citizens' plans to expand its traditional thrift business, as a classic volume business, did not require proof of specific investment opportunities. The common law generally applicable to contract breaches simply does not require an injured party to identify specific lost opportunities as the only way to recover, as the courts below held, particularly in a case where the party is in a high volume business conducting numerous transactions every day that constitute its lost profits.

Holding plaintiffs to such an impossible standard is not only inconsistent with principles stated in decisions of this Court, *see, e.g., Bigelow, supra; Sinclair Refining, supra; Zenith, supra,* but conflicts with uniform decisions of other circuits rejecting the rule that a plaintiff in a high volume business must show specific lost opportunities or sales in order to recover lost profits damages. For example, the Third Circuit has acknowledged that it would be "unduly harsh" to require a plaintiff to "document each sale that it might have made" because "the extent of such hypothetical sales was necessarily an estimate."

Pitchford v. PEPI, Inc., 531 F.2d 92, 105, 108 (3d Cir. 1975). Similarly, the Fifth Circuit has recognized that a plaintiff need not prove a specific lost opportunity, as proof of an active market is sufficient to entitle a plaintiff to lost profits. *In re M/V Nicole Trahan*, 10 F.3d 1190, 1195 (5th Cir. 1994). in *Bob Willow Motors, Inc. v. General Motors Corp.*, 872 F.2d 788, 798 (7th Cir. 1989), the Seventh Circuit held that was it "completely reasonable" to consider national sales trends in proving lost profits because the plaintiff was not required to identify specific or particular purchasers. In rejecting a "specific" opportunity test, the Seventh Circuit concluded that such a rule served no meaningful purpose because it would only require injured parties "to engage in futile acts simply to bolster a litigation position." *Id.* at 799. The Eighth Circuit has likewise held that a plaintiff need not "identify specific lost sales to recover lost profits." *Lundell Mfg. Co. v. ABC, Inc.*, 98 F.3d 351, 365 (8th Cir. 1996).

The implication of the decisions below would require a thrift victim to identify the precise individual loans or specific investment securities that it would have acquired on a given day in the non-breach world. The decisions below cannot be reconciled with law, logic, or common sense. They eviscerate the premise of *Winstar* and reject special rules for obtaining damages against the government in violation of *Mobil Oil*. This Court should put the Federal Circuit back on the right track to prevent the government from unjustly securing a windfall in connection with its breach of *Winstar*-contracts specifically and other contracts generally.

III. WINSTAR DECISIONS LIKE THOSE BELOW WILL HAVE CHILLING EFFECTS WHEN THE GOVERNMENT NEXT SEEKS EMERGENCY ASSISTANCE OF INDUSTRY

After this Court categorically held that the government is contractually obligated to compensate *Winstar* parties for breaching its capital promises, the Federal Circuit's adoption or acquiescence of special rules in lost profits cases to protect the government from bearing the cost of its FIRREA-related breaches has emptied this Court's mandate of any meaning and left responsible thrifts such as Citizens, which itself assumed $40 million of government-insured liability as part of the last industry bailout of the government, without any remedy.

Even after *Winstar* and *Mobil*, the Federal Circuit refrains from holding the government "accountable under the common law of contracts" and continues to "protect[] [it] by special rules and presumptions." W. Stanfield Johnson, *Mixed Nuts and Other Humdrum Disputes: Holding the Government Accountable Under the Law of Contracts Between Private Individuals*, 32 Pub. Contr. L.J. 677, 679 (2003). By relieving the government of the financial consequences of its actions, the courts below have effectively transferred massive obligations from the public fisc to private parties—ironically, the very parties, like Citizens, who previously volunteered to help the government in its time of need, *Winstar*, 518 U.S. at 883, and of course to whom the government would look to in the next financial crisis.

While this Court has repeatedly held that "[t]he United States does business on business terms," the reality of obtaining a remedy against government is a

far cry from this ideal. *Winstar*, 518 U.S. at 895 n.39 (quoting *Clearfield Trust Co. v. United States*, 318 U.S. 363, 369 (1943)). Government contractors--especially those who may be called on to assist the government in a time of crisis—may well and very likely will be deterred, after the *Winstar* experience, from dealing with the government for fear of being stranded holding a right without an effective remedy should the government not keep its word.

This Court has long recognized the benefits that accrue to the public from requiring the government to abide by its financial contracts far outweigh any short-term gains from permitting the government to escape a contractual obligation or limit available remedies out of financial expediency. *See, e.g., Winstar*, 518 U.S. at 883; *id.* at 913 (Breyer, J., concurring)(applying normal contract rules to government "ensures that [it] is able to obtain needed goods and services from parties who might otherwise, quite rightly, be unwilling to undertake the risk of government contracting."). As this Court put it in *Lynch v. United States*, "[p]unctilious fulfillment of contractual obligations is essential to the maintenance of the credit of public as well as private debtors." 292 U.S. 571, 580 (1934)(Brandeis, J.); *see also FPC v. Tuscarora Indian Nation*, 362 U.S. 99, 142 (1960)(Black, J., dissenting)("Great nations, like great men, should keep their word.").

In this case, the government has broken its word twice, first through the enactment of FIRREA, and again when it failed to honor what this Court termed its "agree[ment] to pay damages in the event [its breach] caused financial injury," *Winstar*, 581 U.S. at 871, under principles long articulated by this and other courts.

The lesson many potential government contractors, financial and otherwise, will take from this episode and double breach of promises by the government, is that the government does not consider itself, and is not in the Federal Circuit, obligated to be a "reliable contracting partner." *Winstar*, 518 U.S. at 883. Because the Federal Circuit demonstrably will not enforce traditional contract remedies when the government breaches significant obligations, this Court should grant certiorari to ensure that the benefits of traditional contract rules flow to both the contractors and, in the long run, the government itself.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted,
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August 15, 2006

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(any footnotes trail end of each document)

05-5116

UNITED STATES COURT OF APPEALS
FOR THE FEDERAL CIRCUIT

CITIZENS FINANCIAL SERVICES, FSB (formerly known as Citizens Federal Savings and Loan Association),
Plaintiff-Appellant,

v.

UNITED STATES,
Defendant-Appellee.

March 9, 2006, Decided

March 9, 2006, Filed

NOTICE: RULES OF THE FEDERAL CIRCUIT COURT OF APPEALS MAY LIMIT CITATION TO UNPUBLISHED OPINIONS. PLEASE REFER TO THE RULES OF THE UNITED STATES COURT OF APPEALS FOR THIS CIRCUIT.

JUDGES: RADER, SCHALL, and LINN, Circuit Judges.

OPINION: JUDGMENT

This CAUSE having been heard and considered it is

ORDERED and ADJUDGED:

AFFIRMED. See Fed. Cir. R. 36.

05-5116

UNITED STATES COURT OF APPEALS
FOR THE FEDERAL CIRCUIT

CITIZENS FINANCIAL SERVICES, FSB (formerly known as Citizens Federal Savings and Loan Association),
Plaintiff-Appellant,

v.

UNITED STATES,
Defendant-Appellee.

May 17, 2006, Decided

May 17, 2006, Filed

NOTICE: THIS DECISION WAS ISSUED AS UNPUBLISHED OR NONPRECEDENTIAL AND MAY NOT BE CITED AS PRECEDENT. PLEASE REFER TO THE RULES OF THE FEDERAL CIRCUIT COURT OF APPEALS FOR RULES GOVERNING CITATION TO UNPUBLISHED OR NONPRECEDENTIAL OPINIONS OR ORDERS.

OPINION: ORDER

A combined petition for panel rehearing and for rehearing en banc having been filed by the Appellant, and the petition for rehearing, having been referred to the panel that heard the appeal, and thereafter the petition for rehearing en banc having been referred to the circuit judges who are in regular active service, UPON CONSIDERATION THEREOF, it is

ORDERED that the petition for panel rehearing be, and the same hereby is, DENIED and it is further

ORDERED that the petition for rehearing en banc be, and the same hereby is, DENIED.

The mandate of the court will issue on May 24, 2006

No. 93-306C
UNITED STATES COURT OF FEDERAL CLAIMS

CITIZENS FINANCIAL SERVICES, FSB f/k/a CITIZENS FEDERAL SAVINGS and LOAN ASSOCIATION,
Plaintiff,

v.

THE UNITED STATES,
Defendant.

March 7, 2005, Filed

COUNSEL: Salvatore Scanio, Washington, DC, for plaintiff.

Richard B. Evans, U.S. Department of Justice, Washington, DC, with whom were Stuart E. Schiffer, Deputy Assistant Attorney General, and Director David M. Cohen, for defendant. Brian L. Owsley and John H. Roberson, U.S. Department of Justice, of counsel.

JUDGES: NANCY B. FIRESTONE, Judge.

OPINION BY: NANCY B. FIRESTONE

OPINION:

OPINION

FIRESTONE, *Judge.*

INTRODUCTION

Liability in this Winstar-related litigation was not contested by the government and on May 1, 2002, the court granted the plaintiff's motion for partial summary judgment on the issue of liability. Thereafter, the plaintiff, Citizens Federal Savings and Loan Association ("Citizens") and the government cross-moved for summary judgment on the issue of damages. The background facts of the case are discussed at length in the court's June 25, 2003 initial opinion on damages, in which the court granted in part and denied in part the parties' respective motions for summary judgement. *Citizens Financial Services v. United States, 57 Fed. Cl. 64 (2003).*

As set forth in the June 25, 2003 opinion, Citizens' claims for damages stem from the agreement that it made with the Federal Savings and Loan Insurance Corporation ("FSLIC") during the savings and loan crisis of the 1980s. Under the terms of the agreement, Citizens acquired two failing savings and loan associations, First Federal of East Chicago and Gary Federal. The agreement included a provision granting $ 12.75 million in cash assistance to Citizens and provided that Citizens could:

> (a) mark down First Federal and Gary's assets to estimated market value; (b) count the $ 40.15 million of excess acquired liabilities over the market value of acquired assets as 'supervisory goodwill;' (c) treat the supervisory goodwill as regulatory capital, to be written off on a straight-line basis over thirty-five years; and (d) record a direct credit of $ 12.75 million to its regulatory capital and amortize this 'capital credit' over

> thirty-five years. The agreement between Citizens and the government therefore gave Citizens the right to use $ 52.9 million of supervisory goodwill and capital credit for regulatory capital purposes.

Citizens, 57 Fed. Cl. at 65.

As further discussed in the court's initial damages opinion, following enactment and implementation of the Financial Institutions Reform, Recovery and Enforcement Act of 1989, Pub. L. No. 101-73, 103 Stat. 183 (1989) ("FIRREA"), Citizens had to change the way it used its supervisory goodwill and capital credit for regulatory purposes. In particular, under FIRREA and its implementing regulations, Citizens had to deduct its unamortized $ 28.4 million of supervisory goodwill and $ 10.1 million of capital credit from its regulatory capital accounts on an accelerated basis, eliminating them entirely by 1994. As a result, once FIRREA was implemented, Citizens' regulatory capital declined from 10% of assets to less than 5.5% of assets. Importantly, however, at all times following the implementation of FIRREA, Citizens exceeded all regulatory capital requirements. Consequently, the parties agree that, following the implementation of FIRREA, Citizens needed neither supervisory goodwill nor its capital credit to meet FIRREA's new regulatory capital requirements.

Although Citizens did not need its supervisory goodwill or capital credit to meet the new regulatory capital requirements set forth in FIRREA, it nonetheless contended that it had suffered damages when it lost the right to count these items as capital. Citizens charged in its complaint that it was entitled to

$ 40.15 million based on restitution and reliance theories. In the alternative, it claimed that it was entitled to $ 20.9 million in lost profits.[1] The government sought summary judgment on all of Citizens' damages theories. Citizens sought partial summary judgment on its reliance damages claim. In support of its motion and in defense to the government's motion, Citizens relied primarily on the report of Professor Paul M. Horovitz[2], who later became Citizens' trial expert. In support of its motion, the government relied primarily on the report of Professors Bernard Black and Jeffrey Zwiebel.[3] Professors Black and Zwiebel later became the government's trial experts.

In its summary judgment decision, the court granted the government's motion for summary judgment on Citizens' restitution claim for $ 40.15 million. The court denied the parties' cross motions for summary judgment on Citizens' reliance damage claim; however, Citizens voluntarily dismissed its reliance damage claim before trial.[4] Finally, the court denied the government's motion for summary judgment on Citizens' claim for lost profits based on lost business opportunities.

As discussed in the summary judgment decision, the court found, with respect to Citizens' lost profits claim, that there were disputed issues of material fact which precluded summary judgment. In particular, Citizens presented evidence, including Professor Horvitz's expert report, to establish that, immediately before FIRREA was enacted, Citizens had reached a 10% regulatory capital goal and was ready to begin an aggressive growth strategy. Professor Horvitz explained that because Citizens lost the use of goodwill

and the capital credit after FIRREA, Citizens' regulatory capital ratio fell from 10% to 5%. Although Citizens remained in capital compliance, Professor Horvitz opined that Citizens had to forgo growth opportunities until it could regain its 10% capital level. Professor Horvitz explained that, but for FIRREA, Citizens would have leveraged all of the capital it had in excess of 10% and that Citizens would have invested that excess capital in assets that would have generated the same 1.1% rate of return that Citizens had historically received on its actual assets. Using a model that he had developed for the case, Professor Horovitz opined that Citizens lost $ 20.9 million in profits.

In response, Professors Bernard Black and Jeffery Zwiebel, on behalf of the government, disputed Professor Horvitz's assumption that Citizens would have generated a $ 20.9 million profit on the additional assets it allegedly would have acquired had it grown during the years in question. Professors Black and Zwiebel explained that Professor Horvitz's model was fundamentally flawed. According to Professors Black and Zwiebel, basic economic theory dictates that Citizens could not have obtained the level of incremental assets that Citizens claimed that it lost at the same 1.1% rate of return that Citizens had historically obtained on its existing assets.

After considering the evidence presented, the court concluded that a trial was needed to resolve the issue of lost profits. *Id. at 73.* A trial was held in June and July of 2004. The evidence centered around the following key factual issues: (1) whether Citizens had a 10% regulatory capital goal; (2) whether Citizens' decision to forgo growth for several years following implementation of FIRREA was related to FIRREA;

(3) whether Citizens had to forgo any specific profitable opportunities because of FIRREA; (4) whether Citizens had established $ 20.9 million in lost profits with reasonable certainty; and (5) whether these lost profits were reasonably foreseeable.

The trial was held over the course of four weeks. Nearly 500 exhibits were admitted into evidence. During this time, the plaintiff called and examined the following witnesses: James Prisby, the President and Chief Operating Officer of Citizens, as well as Vice Chairman of Citizens' Board of Directors; David Hostetler, a former government regulator, first with the Federal Home Loan Bank of Indianapolis, followed by the Office of Thrift Supervision ("OTS"); Valentine Craig, a government regulator, formerly with the FSLIC, followed by the Resolution Trust Corporation ("RTC"), and currently with the Federal Deposit Insurance Corporation ("FDIC"); Dr. David Glenn, a former government regulator with the FSLIC; John Stephens, who recently retired from employment with Citizens, where he spent twenty years in various positions including Senior Vice President, Treasurer, Executive Vice President, Chief Financial Officer, and member of the Board of Directors; David Mangian, the Assistant Regional Director of the FDIC for the Midwestern Region; Alfred Westfall, a former government regulator with the Federal Home Loan Bank Board, followed by the Federal Home Loan Bank, followed by OTS; Carl Cortopassi, who is recently retired after twenty years as a bank examiner, first with the Federal Home Loan Bank Board, followed by the Federal Home Loan Bank, and finally by the OTS; Michael Mudroncik, who was a bank examiner, first with the Federal Home Loan Bank, and afterwards

with the OTS; Thomas Prisby, who, in the more than twenty years since he joined Citizens, has held the positions of Executive Vice President, Chief Operating Officer, President, Chief Executive Officer, and, finally, Chairman of the Board of Directors of Citizens; and Professor Horvitz.

In addition to examining some of the same former government regulators as the plaintiff, the government also called and examined: Alford Wilson, formerly the senior field examiner with the OTS in Indianapolis; Brian McDonald, an examiner with OTS; Stephen Davenport, formerly a thrift examiner with the OTS; Jeffrey Sanders, who was previously a financial analyst with the Federal Home Loan Bank, and subsequent to that, with the OTS; Michael Doebereiner, formerly an assistant director with the OTS; Gerald Skrabala, formerly the vice president of operations at Citizens; Thomas Cleveland, who the government proffered as an expert in accounting as it relates to the banking industry; Professor Zwiebel; and Professor Black.

DISCUSSION

When the government breaches a contract, the law requires the government, like any private party, to compensate an injured party for any harm that it has caused. See *Winstar Corp. v. United States, 518 U.S. 839, 868-69, 135 L. Ed. 2d 964, 116 S. Ct. 2432 (1996).* One way that the law endeavors to make the non-breaching party whole is to award him expectation damages, that is, "the benefits he expected to receive had the breach not occurred." *Glendale Fed. Bank v. United States, 239 F.3d 1374, 1380 (Fed. Cir. 2001).* Expectation damages generally include lost profits. *LaSalle Talman v. United States, 317 F.3d 1363, 1371*

(Fed. Cir. 2003). The courts have defined lost profits as "profits that would have been earned but for the breach." *LaSalle Talman, 317 F.3d at 1371*; *California Federal Bank v. United States, 245 F.3d 1342, 1349 (Fed. Cir. 2001)*. The Federal Circuit has stressed that plaintiffs face a heavy burden in proving lost profits in Winstar cases. Indeed, the Federal Circuit has explained that proving lost profits is often a hopeless endeavor in Winstar cases, stating: "Expectancy damages theory, based on lost profits, has proven itself impractical for these [Winstar] cases, and generally not susceptible to reasonable proof. . . . Given the speculative nature of such a damages claim, . . . experience suggests that it is largely a waste of time and effort to attempt to prove such damages." *Glendale Federal Bank v. United States, 378 F.3d 1308, 1313 (Fed. Cir. 2004)*.

Notwithstanding the difficulty of proving lost profits, the theory has not been barred as a matter of law. The Federal Circuit has most recently explained that lost profits are available if a plaintiff can satisfy three requirements: "First, the plaintiff must show that the lost profits were within the contemplation of the parties because the loss was foreseeable. . . . Second, the plaintiff must establish that there would have been a profit but for the breach. . . . Third, the measure of damages must be reasonably certain." *California Federal Bank v. United States, 395 F.3d 1263, 1267 (2005)*. As shorthand, the three elements are referred to as: (1) Foreseeability; (2) Causation; and (3) Reasonable Certainty. See, e.g. *Columbia First Bank v. United States, 60 Fed. Cl. 97, 113, 121 (2004)*; *Commercial Federal Bank v. United States, 59 Fed. Cl.*

338, 344, 354 (2004). The court will deal with each of these elements in turn.

A. Foreseeability

In order to show that the government knew that its breach due to the enactment of FIRREA would cause Citizens to lose profits, the plaintiff called David Hostetler, Valentine Craig, and David Glenn. These witnesses were government regulators who were involved in the oversight of Citizens during portions of the period between the acquisition of Gary and First Federal and the damages period. The plaintiff called these witnesses for the purpose of showing that the government, through its regulators, either had reason to know, or in fact knew, that the loss of supervisory goodwill and capital credit would reduce Citizens' borrowing capacity and therefore could cause potential economic harm. Mr. Hostetler testified that, generally speaking, when the government made goodwill part of an assistance agreement with an acquiring institution like Citizens, the goodwill was leveraged so that the acquiring institution could take on additional deposits. Tr. at 596-97. When asked whether goodwill was "used for growth purposes," Hostetler replied: "A lot of times, yes." Tr. at 597. Similarly, Dr. Glenn testified that one of the purposes of the goodwill assistance was to give Citizens "the ability to generate earnings, cash earnings, by holding assets over the life of the contract." Tr. at 779-80. Dr. Glenn went on to testify that the goodwill assistance program was "designed to give the institution time" to replace the accounting assets with real assets. Tr. at 782. Finally, Dr. Glenn testified that it was foreseeable at the time of the Gary and First Federal deal that if the goodwill was amortized more quickly than anticipated in the deal,

then Citizens' net worth would suffer as a result. Tr. at 826. Finally, Ms. Craig testified that if Citizens' goodwill were amortized after five years instead of over the course of thirty-five years, then she would expect that Citizens would experience less growth and earn less income as a result. Tr. at 765. The plaintiff argues that these statements, from three government regulators with authority over Citizens during the years in question, indicate that the government had reason to foresee that taking away Citizens' supervisory goodwill and capital credit could cause Citizens to lose leverage and therefore potential profits.

In addition, the plaintiff presented evidence in the form of testimony and summary exhibits for the purpose of indicating that the plaintiff would not have been able or willing to undertake the transaction in the absence of the supervisory goodwill component of the assistance agreement. The purpose of this evidence was to show that, because the goodwill provision was an essential element of the bargained-for exchange, it was foreseeable that breaching this provision would damage the plaintiff. The plaintiff presented evidence that, at the time of Citizens' acquisition of First Federal and Gary, and for sometime thereafter, Citizens would have been insolvent if not for the supervisory goodwill. PX 982. Mr. Stephens testified that, for several years after the acquisition, Citizens would have had a negligible or even a negative capital position if the government had taken away Citizens' supervisory goodwill. Tr. at 934-35. The plaintiff argues that Citizens, which was very concerned about its capital position, would not have entered into the agreement if it was aware that it would be left out of capital compliance as a result. Similarly, Professor Horvitz testified that "Citizens

would not conceivably have been interested in doing such a deal because, if they did, they would immediately be subject to being closed themselves the next day." Tr. at 2211-12. Professor Horvitz went on to testify that one of the purposes of the supervisory goodwill was to "assist Citizens in being able to meet their capital targets." Tr. at 2214. See PX 979. The plaintiff argues that, in light of this evidence, the acquisition would have been impossible if not for the goodwill component of the agreement. Because the acquisition would not have taken place without the goodwill component of the agreement, the plaintiff argues, the government knew that this provision was an essential element of the transaction; as a result, it was foreseeable that breaching this provision would cause the plaintiff to lose leverage and therefore potential profits.

While the government does not dispute that lost leverage can lead potentially to lost profits, the government contends that foreseeability in this case turns on whether the government had reason to know of plaintiff's alleged 10% capital goal and therefore the basis of plaintiff's specific lost profits claim. The government argues that, because Citizens had capital to leverage and was in capital compliance following FIRREA, in order to prove foreseeability the plaintiff must show that the government knew that plaintiff would forbear from growth if FIRREA interfered with the plaintiff's internal capital goal. The government argues that, because Citizens' 10% capital goal was not in place at the time of the 1983 assistance agreement, the plaintiff's damages based on a 10% capital goal were not foreseeable. Gov. Rep. Br. at 7. Specifically, the government points to an admission by Mr. Stephens that Citizens did not establish its 10% capital goal until

"after the acquisition of First Federal and Gary Federal," which was, therefore, after the assistance agreement. Tr. at 1229-30. Mr. Stephens went on to testify that Citizens first communicated this goal to government regulators "during the 1988 examination." Tr. at 1234-35.

The government argues that, not only was the 10% capital goal not actually within the contemplation of the parties, but the government also did not have any reason to know that the plaintiff might be inclined, at a later time, to set such a goal. For this conclusion the government points to an admission by Professor Horvitz that Citizens' goal was unique among similar institutions: "Citizens, as distinct from nearly every institution I'm familiar with, they [sic] put enough of a value on that capital goal that they were willing to sacrifice growth in order to - in order to do it. That's a choice that different people with different attitudes towards risk may differ on. But they prized that 10 percent target and were willing to live with the slower growth that implied during the 1980s to reach it." Tr. at 2228.

While the court agrees with the government that the evidence established that the government did not know or have any reason to know of Citizens' 10% capital goal, the court does not agree that knowledge of the 10% capital goal is necessary to establish foreseeability. The foreseeability test is satisfied so long as the government understood at the time of contracting that the plaintiff would use the supervisory goodwill and capital credit it was given in the assistance agreement to meet regulatory requirements as well as to leverage and thus earn potential profits. As the plaintiff's witnesses indicated, the acquisition would not

have been successful if not for the goodwill accounting. The plaintiff has shown that it would not have been receptive to the deal offered by the government had it not included the ability to use goodwill to maintain its capital ratio. In addition, the government regulators testified that it was within the contemplation of the parties that the plaintiff would use the goodwill and capital credit for the purposes of leveraging and growing, with the potential of earning profits. For these reasons, the court finds that the government was aware that the removal of the supervisory goodwill and capital credit before they had been fully amortized pursuant to the assistance agreement could damage the plaintiff and cause it to lose profits. The evidence presented was sufficient to meet the requirements for foreseeability.

The court's conclusion comports with findings by this court in other Winstar-related opinions. See, e.g. *Westfed Holdings, Inc. v. United States, 55 Fed. Cl. 544, 553 (2003)* (finding that "it was foreseeable to both parties that a likely result of the removal of the [assistance provisions] would be [the plaintiff's] failure to meet regulatory capital requirement [sic] which would, in turn, lead to the seizure of the thrift."). See also *Home Sav. of America v. United States, 57 Fed. Cl. 694, 726 (2003)* ("Indeed, there was no mystery about how the thrift would use supervisory goodwill. As the regulators had every reason to know, well-run thrifts . . . were very conscious of their capital ratios. The sudden conversion of negative net worth from an asset (supervisory goodwill) to a liability, would, of necessity, force banks to re-evaluate their capitalization."). So long as the government had reason to know that Citizens intended to leverage its supervisory goodwill and

capital credit, it had reason to know that if Citizens' supervisory goodwill and capital credit were taken away that Citizens would lose potential profits from leveraging that capital. Citizens has, therefore, satisfied the forseeability prong of the lost profits test.

B. Causation

1. Citizens Failed to Prove that it had a 10% Capital Ratio Goal

At the heart of Citizens' lost profit claim is its contention that FIRREA impeded Citizens' previously planned growth strategy because it interfered with Citizens' 10% regulatory capital ratio goal. In particular, Citizens contends that, prior to FIRREA's breach, Citizens was working toward and had achieved a 10% regulatory capital goal and was about to embark on an aggressive growth strategy in which it planned to leverage its regulatory capital above this 10% target. Citizens contends that this growth strategy was put on hold following FIRREA because Citizens' capital fell from 10% to 5%. Citizens argues that, as a consequence, it had to forgo profits while it rebuilt its capital to a preFIRREA 10% level. Citizens further contends that during this capital-rebuilding period it lost growth opportunities that would have generated a $ 20.9 million profit.

In order to evaluate Citizens' causation evidence, it is important to note the different types of "capital" at issue in this case. Prior to implementation of FIRREA in 1990, Citizens was required to meet certain regulatory capital requirements set by the FSLIC. Prior to 1990, Citizens needed to maintain a 3% ratio of capital to assets. In 1989 Citizens had approximately $ 55.7 million in regulatory capital, or 10% of assets.

Citizens therefore had a substantial regulatory capital cushion. This regulatory capital included, as noted above, approximately $ 40 million in unamortized supervisory goodwill and Citizens' capital credit. In 1989, Citizens had tangible capital of $ 15 million, or 2.7% of assets. By the end of 1990, Citizens had tangible capital of 4.98%. DX 2012; DX 2013; DX 2014.

When FIRREA was implemented in 1990, the government imposed several additional capital requirements upon thrifts. Ultimately, thrifts were required to meet core, risk and tangible capital requirements. Citizens acknowledges that it was in full capital compliance following FIRREA, but argues that Citizens nonetheless had to forgo profitable growth opportunities while it worked to increase its regulatory capital ratio to 10%.[5] It is not disputed that during the breach period the minimum core capital requirement was 3%, the risk based capital requirement was 7.5%-8%, and the tangible capital requirement was 1.5%. Upon implementation of FIRREA's regulations in 1990, Citizens was holding capital well above the regulatory minimums. DX 2012; DX 2013; DX 2014. Citizens held core capital of 6.48%, tangible capital of 4.8% and risk-based capital of 15.50%.[6]

In order to prove that Citizens had a 10% regulatory capital goal before and after FIRREA, Citizens presented testimonial evidence from Jack Stephens, Tom Prisby, James Prisby, and Professor Horvitz. Of all the witnesses that Citizens examined at trial, Mr. Stephens was the only one that testified that he had personal knowledge of Citizens' 10% regulatory capital goal. Tr. at 1237. However, Mr. Stephens could not point to any document written during the years either leading up to or following FIRREA in which a 10%

capital goal was stated. Specifically, Mr. Stephens admitted that he could not point to any committee meeting minutes, business plans, or any other internal documents that reflected any capital goal. Tr. at 1238. Similarly, James Prisby admitted that there is no reference to a "10 percent regulatory capital goal that Citizens had" from January 1989 through June 1990 in any committee meeting minutes or Board of Directors meeting minutes. Tr. at 425-26. James Prisby went on to admit that he was not even aware of any specific capital goal, or if there was a capital goal, what that goal was. Tr. at 294-96. Tom Prisby, likewise, admitted that if there was a capital goal, it was not a fixed goal. Tr. at 1991. Specifically, when asked if Citizens' business plans focused on achieving a 10% capital goal, Tom Prisby stated: "I can't be specific. But 7-1/2 percent was a number I used. . . . It could have been 9, it could have been 10. It could have been 7-1/2 to some extent." Tr. at 1991.

Despite hearing these admissions at trial, Professor Horvitz testified that Tom Prisby had told him that Citizens had a 10% capital goal. Tr. at 2426. Professor Horvitz also claimed that Citizens' behavior subsequent to the enactment of FIRREA proved the point. Specifically, Professor Horvitz testified that Citizens started to grow once it reached a 10% regulatory capital ratio in 1993. Tr. 2250-51. However, Professor Horvitz could not point to any contemporaneous document indicating that Citizens in any way acknowledged that it reached a 10% capital ratio or that it planned to change its investment strategy after reaching 10% regulatory capital. Tr. at 2454. Professor Horvitz also admitted that he was not aware of any

documentary evidence to show that Citizens had a 10% regulatory capital goal. Tr. at 2424-25.

In response to Citizens' witnesses, the government presented the testimony of Mr. Cleveland, an accounting expert,[7] who stated that, after reviewing all of Citizens' business plans and public documents, he could not find evidence that Citizens had a 10% regulatory capital goal either prior to or following FIRREA. Tr. at 3025-27. Mr. Cleveland testified that if Citizens in fact had a capital goal, it was probably a GAAP capital goal, or possibly a tangible capital goal, neither one of which was affected by FIRREA. Tr. at 3023. The only mention of a 10% capital goal in any Citizens-related document appeared in the March 13, 1998 Conversion Appraisal Report prepared by an accounting firm in connection with Citizens' conversion from a mutual thrift to stock ownership in 1998. PX 41. In the "Strategic Discussion" of the Conversion Appraisal Report, the accounting firm explained Citizens' capital strategy for the decade from 1983, when it acquired First Federal and Gary, until 1993, as follows:

> For the next decade [following the acquisitions of First Federal and Gary], the focus of management was on increasing the Bank's tangible capital and restructuring the balance sheet. Citizens Financial was largely in a 'no growth' mode over this time frame as it sought to increase earnings, maintain the customer base, and build the tangible capital-to-assets ratio to approximately 10 percent. During this period, the Bank sought to restructure the

> balance sheet with the objective of more closely matching the repricing structure of assets and liabilities and reducing the Bank's interest rate risk exposure. The result of the operating strategy over this period led to a high proportion of assets in securities, particularly mortgage-backed securities ("MBS") with laddered maturities.

PX 41, page CT 0041048 (emphasis added).

Based on his reading of PX 41 as well as Citizens' business plans, Mr. Cleveland opined that removing supervisory goodwill and the capital credit from Citizens' regulatory capital did not affect Citizens' measure of capital; it did not interfere with Citizens' effort to meet either a 10% tangible capital goal or a 10% GAAP capital goal. Tr. at 3023-24. Thus, Mr. Cleveland concluded that while he did not believe that Citizens had a specific capital goal above regulatory minimums, to the extent Citizens had a capital goal, the goal was not affected by FIRREA. Tr. at 3023-24. Based on his conclusion that FIRREA did not change any capital goal that Citizens might have had, Cleveland opined that FIRREA's breach did not cause Citizens to change its business strategy. Cleveland further opined that Citizens' decision not to grow and seek additional profits immediately after FIRREA was not based on capital concerns per se but was based on Citizens' business judgment regarding the opportunities available at the time. Tr. at 3031.

The government also presented the testimony of Professors Black and Zwiebel regarding Citizens' alleged 10% regulatory capital goal both before and after FIRREA. Both testified that an analysis of

Citizens' growth history demonstrated that Citizens did not forbear from opportunities because of adherence to a 10% capital goal that existed either before or after FIRREA. The evidence demonstrated that in 1990, following implementation of FIRREA, Citizens in fact grew by 3.5%. In addition, the evidence established that after Citizens reached its alleged 10% capital goal in 1993, it began to grow slowly and never maintained a 10% capital ratio thereafter. Tr. at 3599. Professors Black and Zwiebel opined that this evidence tends to show that Citizens' growth strategy was not tied to any 10% capital goal.

Taking all of the relevant evidence into account, the court finds that Citizens did not prove that it had a 10% regulatory capital goal prior to and following FIRREA. Particularly important to the court's finding is the fact that neither James Prisby, the President and Chief Operating Officer of Citizens, nor Thomas Prisby, the Chairman of the Board of Citizens, were aware of the alleged 10% goal. The court found it highly probative that neither James Prisby, Thomas Prisby, nor Jack Stephens, the Chief Financial Officer of Citizens, could point to any document prepared by Citizens either prior to or following FIRREA that indicated that there was a 10% regulatory capital goal. Citizens' Assets/Liabilities Committee Meeting minutes, Business Overviews prepared by Citizens in 1991, 1992 and 1993 ("Overviews"), and all the other internal documents of the thrift were very detailed and thorough. The court is persuaded that, if a 10% capital goal existed, then some internal document would have mentioned it. The court finds it difficult to believe that a capital goal, if any existed, would not appear in at least one of Citizens' internal documents over the years,

particularly because these internal documents addressed the thrift's operations with such a high degree of specificity. For instance, the 1993 Overview set forth such mundane goals as "relaminate countertop" and deal with "food odors." The court is persuaded that Citizens did not have a 10% regulatory capital goal.[8] Thus, the court finds that FIRREA did not cause Citizens to forgo growth and potential profits because Citizens wanted to rebuild its capital ratio to 10% of assets.[9] Because Citizens was in full regulatory compliance following FIRREA, because it was able to maintain a cushion above all regulatory minimums, and because it did not have a specific capital cushion governing its business strategy, Citizens was free to grow after FIRREA. Indeed, as Mr. Stephens testified, the court is convinced that Citizens' decision not to grow after FIRREA was based on Citizens' "independent business decision." Tr. at 1221. FIRREA's breach, therefore, did not cause Citizens to lose profits on the ground that Citizens could not grow until it rebuilt its capital ratio to 10% of assets.

2. Capital Concerns did not Prevent Citizens from Pursuing any Specific Investment Opportunities

The court has also considered Citizens' additional evidence that FIRREA directly interfered with Citizens' ability to pursue specific business opportunities. In particular, the plaintiff's witnesses testified that Citizens was not able to pursue the acquisition of other institutions because of capital concerns raised by FIRREA's new capital requirements. Citizens' witnesses also discussed various loan products and expansion efforts from which it had to forbear following FIRREA because of similar

concerns. For the reasons discussed below, the court finds that Citizens did not prove that it lost any profits due to capital concerns that kept Citizens from pursuing specific investment opportunities.

First, the plaintiff presented documentary evidence in the form of business plans from the early 1990s as well as testimonial evidence, most notably from Thomas Prisby and James Prisby, which indicated that Citizens did not pursue mergers with other institutions because such mergers might dilute its capital.[10] In its Overviews, Citizens' management reported that: "Mergers will be limited. A local institution willing to merge will be explored only if there is no dilution of capital. Mergers will not actively be sought. Although RTC acquisitions have been evaluated in the past, future explorations will be minimal. Historically sales have brought serious diminishment of capital to acquiring institutions." See, e.g. 1991 Overview, PX 305. The 1992 and 1993 Overviews contain nearly identical statements. See PX 309; PX 312.

With regard to these statements in the Overviews, Tom Prisby explained that: "We were at a seriously low level of capital in terms of the requirements at that point in time. We would not have sought anything that would have brought any dilution to capital." Tr. at 1928. As a consequence, the plaintiff argues that Citizens lost the opportunity to acquire one of the many institutions being offered by the government for sale through the RTC during the post-FIRREA period. Mr. Prisby testified that these RTC sales included some thrifts that Citizens would have considered purchasing but for the breach and the concomitant reduction of Citizens' regulatory capital. Tr. at 1937-1946. Mr. Stephens also testified as to lost merger opportunities.

Although Mr. Prisby and Mr. Stephens identified several institutions that Citizens allegedly considered acquiring, neither could point to any contemporaneous evidence tending to show that Citizens actually engaged in calculations to determine whether acquiring a particular institution would have, in fact, caused Citizens to fall below acceptable capital levels. The testimony confirmed that Citizens never approached the RTC regarding any specific acquisition nor did the RTC ever reject any application by Citizens for any acquisition. Therefore, there was no evidence introduced to suggest that a merger would not have been approved because of concerns for Citizens' capital level.

Furthermore, Citizens did not present any evidence to prove that acquiring any of the institutions on the RTC list would have been profitable. Professors Black and Zwiebel presented compelling testimony to show the premiums that are normally paid to acquire institutions like those on the RTC's list place into doubt whether Citizens would have made a profit for many years, if ever, from acquiring one of these institutions. Tr. at 3199; 321011 (Statement of Zwiebel); Tr. 3790-1 (Statement of Black).

Professor Horvitz did not counter the assertions of Professors Black or Zwiebel regarding premium payments. Although Professor Horvitz testified regarding a hypothetical acquisition and suggested that such an acquisition would be profitable, he did not present any evidence to show that any of the RTC institutions that Citizens was allegedly thinking of acquiring could have in fact generated profits during the damages period.

Citizens also failed to establish how FIRREA caused Citizens to lose profitable opportunities outside the arena of RTC acquisitions. For example, James Prisby testified that there was a "virtually unlimited" supply of mortgage-backed securities to buy. Tr. at 255. However, in contradiction to this statement, James Prisby also testified that he could not recall any "specific growth opportunities" that Citizens had to forgo because of FIRREA. Tr. at 464.

Citizens also failed to prove that its decision not to offer potentially more lucrative products, such as higher interest rate fixed-price mortgages was caused by FIRREA. Tom Prisby stated that Citizens used to offer 30 and 15 year fixed-price mortgages to customers before FIRREA; after FIRREA, Citizens became concerned about offering long-term, fixed-rate obligations. Tr. at 1756. Mr. Prisby testified that Citizens stopped offering these products for the years 1990, 1991, and 1992, the years immediately following FIRREA. Tr. at 1759-60.

Mr. Prisby's testimony, however, must be examined in light of contemporaneous documentary evidence that undercuts his explanation of why Citizens ceased offering 15 and 30 year fixed-rate mortgages. In its 1992 Overview, Citizens states that it is "restricted by sound GAP management to adjustable products." PX 309. Citizens' 1993 Overview contains identical language. PX 312. The court also heard testimony regarding the uncertainty surrounding interest rates during this period. In addition, Mr. James Prisby testified that he couldn't recall whether FIRREA was a bar to any sort of lending opportunities that Citizens otherwise would have taken. Tr. at 464. From these contemporaneous statements in Citizens' Overviews,

and the testimony received, the court may infer that Citizens' decision to stop offering fixed rate products which were potentially more profitable was not caused by FIRREA, but was instead part of Citizens' larger business strategy, including a legitimate concern about fluctuating and unstable interest rates during the early 1990s.

The evidence established that Citizens' rejection of other business opportunities was also driven by considerations not directly related to FIRREA. For instance, when testifying about Citizens' 1990 business plan, Mr. Tom Prisby admitted that Citizens decided not to pursue a trust operation or a security brokerage operation, because these lines of business were "not something we wanted to spend the money on." Tr. at 1753. In this regard, it is important to note that Mr. Tom Prisby did not say that Citizens was unable to spend the money on these activities due to capital constraints, but rather it was making a business judgment to forgo these opportunities. In other words, Tom Prisby had determined that these lines of business would not be sufficiently profitable to warrant the investment of capital.

The government's witnesses confirmed that Citizens' decisions to not to pursue business opportunities following FIRREA were not based on capital concerns. In this connection, Professor Zwiebel testified that Citizens in fact had opportunities to improve its capital position but did not pursue these opportunities. Professor Zwiebel noted that if Citizens sold certain bad loans that it had acquired, then it would have increased its capital ratio. Tr. at 3226-28. Although Citizens' witnesses testified that it would not have been profitable to sell these loans, they did not

dispute that Citizens could have improved its capital position by selling these loans, yet failed to do so. Similarly, Professor Zwiebel testified that Citizens could have converted to a stock institution earlier if Citizens had wanted to improve its capital position following FIRREA. Professor Zwiebel inferred from Citizens' behavior that the reason Citizens did not seek to raise additional capital was because Citizens did not perceive that there were sufficiently profitable opportunities available to warrant a capital infusion. Tr. at 3245-47.

Finally, the court rejects Citizens' contention that FIRREA caused Citizens to forgo growth opportunities because Citizens was worried generally about the regulatory climate following FIRREA. Citizens notes that it was warned by regulators that it was "marginal" and that in 1990 the regulators had downgraded Citizens' capital rating from "1" to "2." More generally, Tom Prisby testified about the uncertain regulatory environment after FIRREA that prompted Citizens' conservative strategy: "there was constant pressure to meet certain standards. . . . [After FIRREA there were c]onstant conversations of, again, confiscation, special assessments, mutuals having more capital than they needed, all of that conversation. . . . It was a changing regulatory environment. It was very undeterminable in terms of where the future was. And this existed from '83 [onward]." Tr. at 1775-76.

The court finds that Citizens' alleged concerns about its regulatory health following FIRREA did not cause Citizens to forgo profits. The evidence offered by the government at trial paints a very different picture of Citizens' regulatory health. As opposed to many other institutions, Citizens did not receive a lot of attention

from regulators post-FIRREA. Tr. at 2891-92. Citizens was considered, in the words of a government regulator, to be a "well-run shop with good capital, conservative. . . . Low risk. . . . The institution was well managed." Tr. at 2897.

With the foregoing in mind, the court finds that Citizens' contention that FIRREA caused Citizens to forgo profitable business opportunities fails for lack of proof. Although there is no doubt that Citizens' regulatory capital was reduced following FIRREA, the plaintiff has failed to prove that Citizens failed to make investments because of the reduction in its regulatory capital following FIRREA.

3. Conclusion on Causation

In order for a court to find lost profits, the plaintiff must prove that "the profits are such as would have accrued and grown out of the contract itself, as the direct and immediate results of its fulfillment." *Wells Fargo v. United States, 88 F.3d 1012, 1023 (Fed. Cir. 1996)* (emphasis added). The Federal Circuit has now made it plain that the breach must be more than a "substantial factor" in causing lost profits. *Cal. Fed., 395 F.3d at 1268*[11]. The plaintiff must be able to prove that "but for the breach" profits would have been made. *Id. at 1268.* For the reasons set forth above, the court finds that Citizens failed to satisfy the "but for" element of causation; that is, Citizens has failed to prove that but for FIRREA it would have leveraged a set amount of capital in an effort to make additional profits. Citizens did not prove that it had a 10% capital goal which precluded it from growing following FIRREA. To the contrary, the court is persuaded that Citizens' growth strategy after FIRREA was not tied to a specific

capital ratio goal. The plaintiff's claims regarding a 10% goal were not supported by any documentary evidence and were not credible. Citizens failed to prove that FIRREA interfered with a pre-FIRREA growth strategy.

In addition, Citizens failed to prove that FIRREA caused it to forgo any specific business opportunities because of capital concerns. Citizens did not prove that it considered and rejected any specific merger with an institution on the RTC list because of capital concerns. While there was some general reference to concerns about Citizens not wanting to "dilute capital" there is no contemporaneous evidence to show that Citizens evaluated any specific merger to determine whether it would jeopardize Citizens' capital position to the detriment of its relationship with its regulators. The testimony of the regulators persuaded the court that Citizens' financial soundness was never in question after FIRREA and that Citizens would have been free to pursue mergers after FIRREA.

Further, Citizen could not identify any other areas of business that it did not pursue because of capital concerns following the enactment of FIRREA. James Prisby could not identify a single investment Citizens did not or could not make because of FIRREA. The evidence also established that Citizens' decision not to offer certain loan products or other financial services was based predominately on interest rate concerns. Thus, the court finds that Citizens' decision to forgo any investment or pursue other avenues of business was based on its belief that these investments were not worth the financial risk. In other words, the court infers from the evidence presented that Citizens' decision not to pursue various business opportunities following

FIRREA was based on its independent business judgment and was not caused by the loss of regulatory capital.

In this connection, Citizens' assumption that the loss of leveragable capital necessarily means that Citizens lost profits is not supported. Leverage only gives rise to potential profits. Leverage also has the potential for losses if the rate spreads are negative. Therefore, whether to use leverage to grow turns on a variety of practical factors which are evaluated as are all other business decisions. While capital position is always a consideration in the banking industry, it is not necessarily the predominant concern where, as here, the thrift is in capital compliance and operating well above all regulatory minimums standards. Citizens failed to prove that concern with its capital position following FIRREA dominated its business decision-making. Instead, the court is persuaded that Citizens did not grow or pursue various business opportunities immediately following FIRREA because Citizens did not believe that those opportunities would be profitable or worth the risk. For these reasons the plaintiff has failed to prove causation, a required element of a lost profits claim.[12]

C. Reasonable Certainty

Having concluded that Citizens failed to establish causation, the court's inquiry would ordinarily be at an end. Nonetheless, even if the court were to find that Citizens established causation, for the reasons set forth below the court finds that the plaintiff failed to prove lost profits with reasonable certainty; thus its lost profits claim must fail on this ground as well.

In order to prove that it is entitled to $ 20.9 million in lost profits, the plaintiff relies on the damages model authored and explained by Professor Horvitz and on the factual testimony, primarily, of the Prisby brothers and Jack Stephens. At trial, Horvitz presented a lost profits model that calculated how much profit Citizens allegedly lost between the time of the breach, in 1990, and when Citizens converted from a mutual thrift to a stock corporation in 1998. The plaintiff does not seek damages beyond the time of conversion.[13]

Professor Horvitz's model hinges on two major assumptions. The first is that the plaintiff had a 10% capital goal and would have leveraged all of its regulatory capital above that goal to obtain assets. The second is that Citizens would have received the same rate of return on these incremental assets as it had historically achieved on its existing asset base. The uncertainties associated with both of these assumptions are fatal to the plaintiff's claim.

1. Citizens Did Not Have a 10% Capital Goal or a Business Strategy for Significant Growth

As discussed in detail above, the court has concluded that Citizens did not prove that it had a 10% capital goal. The court cannot accept the assumption made by Professor Horvitz that Citizens' business strategy was driven by a plan to leverage all of its capital over a 10% capital target. Therefore, a damages model based upon a 10% capital goal is by its terms without value.

The court has also found that Citizens' decision not to leverage its excess capital following FIRREA was not based on concerns with its level of capital but rather was based on other business factors. In this

connection, the court cannot accept that Citizens would have grown at the rate assumed by Professor Horvitz in his model. Professor Horvitz's model assumes that Citizens would have grown by nearly 20% and would have acquired over $ 100 million in additional assets in the first year following FIRREA. The model assumes that Citizens would have acquired over $ 350 million in assets in just a few years. These growth assumptions are wholly speculative. There was absolutely no contemporaneous evidence in any of Citizens' business plans either prior to or following FIRREA that suggests that Citizens would have or could have expanded its asset base by that amount. Citizens grew at an annual rate of 1.5% to 4.4% in the three years prior to FIRREA. It also grew only at a modest rate after reaching a 10% regulatory capital ratio. Given Citizens' history, the growth assumptions in Professor Horvitz's model strain credulity and therefore raise serious concerns about the reliability of Professor Horvitz's model.[14]

2. Horvitz's Assumptions about a Guaranteed Return on Incremental Assets Were not Supported

In order to support this economic model, Professor Horvitz explained that he assumed, for purposes of his model, that Citizens would acquire assets in the same percentages as those which it held in its actual asset portfolio at the time of the breach. Although Professor Horvitz made this assumption in his model, he acknowledged that both the growth rate and rate of return on assets were assumptions that needed to be supported by real world facts in order to be reliable. He testified that "one can't simply assume that they would get the assets or that - assume that they would earn the same return. I think . . . it's legitimate to question the

modeling on the basis of: Are those assets available, and what would the returns be? I think it takes evidence as to where they would come from and what they would yield." Tr. at 2310.

While Professor Horvitz recognized the importance of examining available assets and yields, he did not present any evidence to support the asset and yield assumptions in his model. Aside from providing the court with general testimony regarding the "limitless" availability of various mortgage-backed securities, Professor Horvitz never explained exactly how Citizens' asset portfolio would be structured. Professor Horvitz did not think it mattered. He asserted that "regardless of what that combination of assets is," the thrift would still earn a 1.1% rate of return. In fact, Professor Horvitz testified that Citizens would have been able to earn the same 1.1% rate of return if it invested entirely in mortgage-backed securities and had acquired them with only jumbo CDs. However, he presented no evidence to show which mortgage-backed securities were available during the forgone-asset period and whether Citizens would have been willing to accept the level of risk associated with those securities.

In this connection, the court is mindful of the testimony it heard from James Prisby, who was responsible for Citizens' investment strategy. Mr. Prisby agreed with Professor Horvitz that Citizens could have purchased a "virtually unlimited" amount of mortgage-backed securities. Tr. at 255. However, he later admitted that these assets did not always offer a satisfactory return: "I'm not saying that the spreads were always where we would have liked them to be." Tr. at 521. The limited evidence the court received regarding mortgage-backed securities did not provide

the court with a level of certainty regarding the availability of specific securities which would have yielded Citizens a profit, taking into account the cost of raising those funds. The court did not receive any evidence to show what specific investments could have been made and what the yields would have been. Without this evidence, the court does not have confidence that there were mortgage-backed securities available in the volume alleged and with yields that would support Professor Horvitz's assumed guaranteed rate of return.

The court was also persuaded by the testimony of Professors Black and Zwiebel, who both explained that Professor Horvitz's model ignored basic economic principles. In brief, Professors Black and Zwiebel testified that there is no economic support for a model that assumes a guaranteed 1.1% rate of return regardless of the growth rate. They explained the issue as follows: if Citizens began to search for more and more assets to purchase, it would first purchase the highest quality assets, that is, those with the highest rate of return for the least amount of risk. However, there are not an unlimited amount of assets of the highest quality. Therefore, as Citizens attempted to continue to deploy its capital, it would be forced to purchase riskier assets or those which offer a lower rate of return. Tr. at 3144. Professor Black explained that it is for this reason that Citizens' expected return on its incremental assets would be increasingly smaller than the rate it actually received on the assets it already owned. Tr. at 3639.

In view of these expert opinions, the court takes exception with James Prisby's testimony that the plaintiff would have earned more profit with more

capital because it could then have invested in riskier securities and received a higher rate of return. In short, Mr. Prisby's statement reveals the fundamental flaw in Horvitz's model. If an investment has a higher potential yield than a comparably available investment, it is only because it is concomitantly more risky and therefore more likely to generate a loss. Conversely, if there are two investments, one of which is more attractive than the other because it has a higher expected yield at the same level of risk, all incoming investment will flow to the better-paying investment until demand for it increases, driving up the cost of purchasing it, thus making it no more profitable than the other investment.

In view of the foregoing, the court agrees with Professors Black and Zwiebel that Professor Horvitz posited a hypothetical world in which Citizens is able to take advantage of investment opportunities that persist indefinitely above a market rate without diminishing returns: in short, it is modeled to have a guaranteed rate of return for an unlimited deployment of assets. The model is therefore flawed. Indeed, in the real world the evidence established that once Citizens began to grow that it did not maintain a steady rate of return. Instead, it decided to purchase some riskier investment with the inevitable consequence that it suffered some losses.[15]

In short, Professor Horvitz could have posited a 1.1% return on assets, or he could have posited unlimited growth, but he cannot assume both of these elements in the real world. The result of Horvitz's flawed model is that there is no limit to growth and to profit. Citizens could, in Horvitz's model, continue to leverage and grow and earn profits, guaranteed profits, without end.

The flaws in Professor Horvitz's model become most apparent if we assume that Citizens had less than a 10% capital ratio. Professor Horvitz admitted that, if Citizens had a lower capital goal than the 10% goal he assumed, then Citizens' lost profits would increase exponentially. Tr. at 2387-89. If Professor Horvitz had used an 8% capital goal, then Citizens would have lost $ 48,000,000 in profits under Professor Horvitz's model. If Citizens had a 4% capital goal, then it would have lost profits of $ 257,000,000. Lastly, and to drive the point home, if Citizens had leveraged all of its assets according to Horvitz's model, retaining no capital, its lost profits for an eight-year period would be infinite. Tr. at 3276. Any model that could yield such an absurd result cannot be reliable.

3. Conclusion on Reasonable Certainty

The court finds that the above-cited problems with Professor Horvitz's lost profits model are enough to defeat Citizens' claim for lost profits in this case.[16] Citizens failed to prove lost profits with the degree of certainty required to support an award. The court is cognizant of the fact that when a "reasonable probability of damage can be clearly established, uncertainty as to amount will not preclude recovery." *Cal. Fed., 395 F.3d at 1267.* However, the plaintiff must still be able to prove that the measure of damages sought is "reasonably certain." Id.

Here, because of the above-discussed flaws in Professor Horvitz's model, Citizens failed to meet its burden. First, Professor Horvitz's model was based on the unsupported assumption that Citizens had a 10% capital target. The court found that Citizens did not have a 10% capital target. Second, Professor Horvitz's

model assumed a growth rate that was not consistent with Citizens' generally conservative business plans. Nowhere in any preFIRREA business plan did Citizens indicate that it was contemplating the nearly 20% growth rate in 1990 that Professor Horvitz relied upon in his model. Third, Professor Horvitz could not identify with any specificity which investments, whether mortgage-backed securities or other assets, would have guaranteed Citizens the 1.1% rate Professor Horvitz assumed in his model. Without offering any specifics, Professor Horvitz simply assumed that there would have been attractive mortgage-backed securities or other opportunities available to Citizens in a world absent FIRREA. Fourth, Professor Horvitz's model did not comport with basic economic principles. The model erroneously assumed that Citizens could grow to any size and still maintain a guaranteed 1.1% profit.

The flaws which have led this court to conclude that Citizens failed to prove lost profits with reasonable certainty are consistent with other decisions of this court which have held that absent proof of specific investments that would have been held in the world absent FIRREA, a lost profits claim is too speculative. See, e.g. *Long Island Sav. Bank v. United States, 60 Fed. Cl. 80 (2004)* (holding that damages may be too speculative if a plaintiff is unable to "point to actual profitable opportunities that it has foregone."); *Standard Fed. Bank v. United States, 62 Fed. Cl. 265 (2004)*; Southern Nat'l *Corp. v. United States, 57 Fed. Cl. 294 (2003)*; *Fifth Third Bank of Western Ohio v. United States, 55 Fed. Cl. 223 (2003)*. The Fifth Third plaintiff's expert calculated lost profits in that case "as the product of the incremental assets and the incremental return that the But-for Bank would have

earned." *Fifth Third, 55 Fed. Cl. at 228.* The expert postulated that the bank's "expanded asset base would realize profits at a similar rate to that of its actual profits." *Id. at 241.* The court found that the model's

> outstanding flaw is the assumption that the But-for-Bank would, even if it could, engage in the same type of activities without identifying any specific investments or opportunities, and that these activities would produce the same results . . . as the actual business activities in which plaintiff engaged. . . . This deficiency renders plaintiff's model speculative as a matter of fact and law.

Id. at 241.

In a similar case, *Southern National Corp. v. United States, 57 Fed. Cl. 294, 304-305 (2003),* the court found that its expert report suffered from the same infirmities as the expert report in Fifth Third. Particularly, the Southern National court found that its plaintiff's expert's model was too speculative because it assumed that the rate of return on the incremental assets of the but-for bank would parallel the thrift's actual past earnings. *Id. at 305.*

This court made similar determinations in Standard Federal. In holding that the plaintiff's claim for lost profits was too speculative, the court relied on the following facts: 1) the lost profits model assumed that the plaintiff would have grown in the same way and profited at the same rate as it did in the pre-breach world; and 2) the lost profits model assumed that the institution would have engaged in the same types of

investments as it had in the but-for world, without identifying these specific investments. *Standard Federal, 62 Fed. Cl. at 279-80, 285.*

Most recently, the court in LaSalle Talman reached the same conclusion on similar facts. In rejecting the lost profits claim, the court stated, "We conclude that the twin uncertainties of both the amount and composition of foregone assets and the hypothetical rate of return preclude recovery under plaintiff's earnings-on-foregone-assets projection." *LaSalle Talman Bank, F.S.B. v. United States, 64 Fed. Cl. 90, 2005 U.S. Claims LEXIS 32 (2005).* Similarly, in Southern California, the court rejected another model presented by Professor Horvitz, in part, because Professor Horvitz's assumption that incremental assets would yield a fixed rate of return was not supported. *Southern California, 57 Fed. Cl. at 625-27.*

In view of this overwhelming authority, Professor Horvitz's model does not provide the court with a reasonably certain measure of lost profits.[17] Nor did Citizens provide the court with any other means of determining lost profits with reasonable certainty. As a result, the claim must be rejected.[18]

CONCLUSION

In conclusion, the plaintiff has failed to prove that the breaching provisions of FIRREA caused the plaintiff to lose profits. Accordingly, the Clerk shall enter judgment for the government.[19] Each party will bear its own costs, except that the government shall be awarded costs in connection with Citizens' reliance damages claim. In particular, the government is entitled to the costs it incurred in defending against Citizens' reliance claim for the period following issuance

of the court's 2003 opinion until the time at which Citizens abandoned the claim prior to trial.

s/ Nancy B. Firestone

Judge

Footnotes

n1 Citizens also contended that it was entitled to $ 31.1 million, which Citizens claimed would have been the cost of replacing the regulatory capital it lost following the enactment of FIRREA. Eventually, Citizens abandoned its claim for damages on this basis. *Citizens, 57 Fed. Cl. at 71.*

n2 Professor Horvitz holds a Ph.D. in Economics from the Massachusetts Institute of Technology ("MIT"). He worked at the Federal Reserve Bank of Boston as a financial economist and, later, at the Office of the Comptroller of the Currency and the Federal Deposit Insurance Corporation, where he attained the position of deputy to the chairman. Subsequently, Professor Horvitz became a professor of financial markets, financial institutions, and management of financial institutions at the University of Houston. He has been accepted as an expert and testified in several other Winstar cases, including *Southern California Federal Sav. and Loan Ass'n v. United States, 57 Fed. Cl. 598 (2003)*, *California Federal Bank v. United States, 43 Fed. Cl. 445 (1999)*, and *Glendale Federal Sav. Bank v. United States, 43 Fed. Cl. 390 (1999)*. Professor Horvitz was proffered and accepted as an expert in banking and finance to testify as to the damages suffered by Citizens as a result of the government's breach of contract.

n3 Professor Bernard Black holds a J.D. from Stanford Law School and at the time of trial was a Professor of

Law at Stanford. Professor Black has taught classes in corporate acquisitions and corporate finance. Professor Black was proffered and accepted as an expert in corporate finance, corporate management, and corporate mergers and acquisitions. Professor Jeffrey Zwiebel holds a Ph.D. in economics from MIT. Currently a professor of economics and finance at Stanford University, Professor Zwiebel teaches graduate level corporate finance and mergers and acquisitions. Professor Zwiebel was proffered and accepted as an expert in microeconomics, corporate finance, and financial economics.

n4 On April 1, 2004, two months before trial, the plaintiff voluntarily dismissed its reliance damages claim, leaving only the above-mentioned lost profits theory for consideration at trial.

n5 More specifically, Citizens decided to increase capital by acquiring assets without acquiring offsetting liabilities. In general, Citizens elected not to grow its deposits but rather to acquire assets with the profits earned on its existing assets.

n6 In 1991, Congress passed the Federal Deposit Insurance Corporation Improvement Act of 1991, Pub. L. No. 102-242, 105 Stat. 2236 ("FDICIA"), which identified several levels of capitalization and set forth criteria for "well," "adequately," and "under-capitalized" thrifts. It is not disputed that at all times following implementation of FDICIA Citizens was considered "well-capitalized ." Tr. at 1219.

n7 Mr. Cleveland received an MBA from the University of Michigan. He went on to work for the accounting firm of Touche, Ross & Company where he helped form

a banking group. He became the national director of all banking services, including work in tax, consulting, auditing, and accounting. Mr. Cleveland later served as CEO and CFO of several thrifts and savings and loan associations. Mr. Cleveland was proffered and accepted as an expert in accounting as it relates to the banking industry.

n8 The court heard substantial testimony regarding the reasonableness of a 10% capital cushion in the thrift industry. However, because the court finds that Citizens did not have a 10% regulatory capital goal, it is not necessary for the court to consider Citizens' claim that a 10% regulatory capital goal provided a reasonable "capital cushion."

n9 Because the court has determined that Citizens did not have a 10% capital goal, it does not address, in the section on causation, whether Citizens' alleged lost growth would have inevitably led to lost profits. This issue is addressed at length in the reasonable certainty section of the opinion. The court notes, however, that proof of lost leveraged growth does not necessarily prove lost profits. As set forth in the section on reasonable certainty, the court finds that Citizens did not prove that the incremental growth it claims to have lost because of FIRREA would have generated any profit. See infra part C.

n10 Citizens did undertake a merger with another thrift, Anchor, during this period. Citizens argues that this merger was acceptable to it because it did not dilute its capital position.

n11 The plaintiff's reliance on several earlier cases in this court that applied a "less exacting" "substantial

factor" test is misplaced following the Federal Circuit's decision in Cal. Fed. In Cal. Fed. the Federal Circuit expressly rejected the "substantial factor" test. *Cal. Fed., 395 F.3d at 1268.*

n12 Because the court has concluded that Citizens failed to establish causation, the plaintiff's suggestion that the court find that Citizens would have grown at least to the same extent as its "peer" group but for FIRREA fails. For all of the reasons discussed above, the court concludes that Citizens failed to prove how FIRREA kept plaintiff from growing to the same extent as its peer group.

n13 Professor Horvitz opined that, due to the conversion, Citizens reached the size it would have attained but for the breach; consequently, he testified that Citizens would not have accrued additional damages beyond this point in time.

n14 Professor Horvitz endeavored to explain that Citizens might have been able to achieve this same level of growth through an acquisition. It is not disputed, however, that Professor Horvitz's model was not based on an acquisition. In addition, as discussed above, the court was not persuaded that an acquisition would have been profitable. Professor Horvitz's model did not present any credible evidence to establish that an acquired institution with an existing portfolio of assets and liabilities would have been able to generate the guaranteed 1.1% return on assets, which is at the heart of Professor Horvitz's model.

n15 For example, in 1997 Citizens took a loss on a real estate investment which Citizens had hoped would generate a return greater than the return it received on average. Tr. at 3812-15.

n16 Given the court's conclusions regarding Professor Horvitz's model, it is not necessary for the court to consider the government's additional objections to Professor Horvitz's model. For example, the government objects to Professor Horvitz's failure to consider the impact of an economic recession during the early 1990s. The government also contends that Professor Horvitz included capital in the hypothetical world that would not have existed, including supervisory goodwill that would have otherwise been written-down. It is not necessary for the court to consider these other methodological flaws.

n17 Because the court has already found that Citizens did not establish causation, there is no need to address plaintiff's plea for a "jury verdict" award. If the plaintiff had proven that lost profits were caused by the government's breach, then this court would have been authorized to return a so-called "jury verdict." "In estimating damages, the Court of Claims occupies the same position of a jury under like circumstances; and all that the litigants have any right to expect is the exercise of the court's best judgment upon the basis of the evidence provided by the parties." *Bluebonnet Sav. Bank v. United States, 266 F.3d 1348, 1357 (Fed. Cir. 2001)* (citing *Specialty Assembling & Packing Co. v. United States, 355 F.2d 554, 572, 174 Ct. Cl. 153 (Ct. Cl. 1966)*. Consistent with the above admonition, however, a jury verdict is allowed only if "there was clear proof of injury and there was no more reliable method for computing damages-but only where the evidence adduced was sufficient to enable a court or jury to make a fair and reasonable approximation." *Bluebonnet, 266 F.3d at 1357*. A jury verdict is not utilized until "clear proof of injury exists." *Dawco Constr., Inc. v. United*

States, 930 F.2d 872, 880 (Fed. Cir. 1991) (reversed on other grounds). Where, as here, Citizens failed to prove an injury, the jury verdict method is not appropriate.

n18 Because Citizens failed to prove damages, it is not necessary for the court to address the government's contention that Citizens also failed to mitigate damages.

n19 The outstanding motions in this case are hereby resolved as follows: The plaintiff's June 14, 2004 Motion for Leave to Include an Additional Exhibit is GRANTED only as to Appendix A and Appendix B, which are composed of excerpts from the Code of Federal Regulations. The plaintiff's June 14, 2004 motion is otherwise DENIED. The plaintiff's July 6, 2004 Motion to Strike DX 2071, DX 2072, DX 2073, DX 2079 and Related Testimony of Professor Jeffrey H. Zwiebel is DENIED. The government's July 4, 2004 Motion for Judgment upon Partial Findings is DENIED as MOOT. The plaintiff's August 20, 2004 Motion to Correct the Trial Record is GRANTED. The plaintiff's May 19, 2004 Motion to Exclude the Black-Zwiebel Regression Analysis is GRANTED. The analysis was not relevant and not considered by the court. The plaintiff's June 9, 2004 Motion for Leave to Amend Plaintiff's Trial Exhibit List is DENIED. The plaintiff's May 19, 2004 Motion to Exclude Opinions of Professors Black and Zwiebel that Exceed the Scope of their Expertise are hereby DENIED. The court found both the testimony of both experts' helpful, relevant, and within the scope of their expertise to the extent that it helped elucidate the flaws inherent in Professor Horvitz's model. The plaintiff's August 19, 2004 Motion to Strike Certain Testimony of Professor Bernard S.

Black is DENIED. All other motions not specifically addressed in this opinion are hereby DENIED.

No. 93-306C

UNITED STATES COURT OF FEDERAL CLAIMS

CITIZENS FINANCIAL SERVICES, FSB f/k/a CITIZENS FEDERAL SAVINGS and LOAN ASSOCIATION,
Plaintiff,

v.

THE UNITED STATES,
Defendant.

June 25, 2003, Filed

JUDGES:

NANCY B. FIRESTONE, Judge.

OPINION BY:

NANCY B. FIRESTONE

OPINION: FIRESTONE, Judge.

This matter comes before the court on the defendant's ("government's") motion for summary judgment on all of plaintiff Citizens Federal Savings and Loan Association's ("Citizens'") damage and restitution claims in this Winstar-related case. Also pending is Citizens' cross-motion for partial summary judgment on reliance damages. The government conceded the issue of liability and on May 1, 2002, plaintiff's motion for partial summary judgment on liability was granted.

For the reasons that follow, the government's motion for summary judgment is **GRANTED, IN PART, AND DENIED, IN PART.** The plaintiffs cross-motion for partial summary judgment on reliance is **DENIED.**

BACKGROUND

I. FACTS

In 1983, Citizens acquired two failing savings and loan associations, First Federal of East Chicago ("First Federal") and Gary Federal ("Gary"). The acquisitions were accomplished through mergers that were arranged by the Federal Savings and Loan Insurance Corporation ("FSLIC"). As part of the arrangement, the FSLIC gave Citizens $ 12.75 million in cash assistance. The FSLIC also agreed that Citizens could (a) mark down First Federal and Gary's assets to estimated market value; (b) count the $ 40.15 million of excess acquired liabilities over the market value of acquired assets as "supervisory goodwill;" (c) treat the supervisory goodwill as regulatory capital, to be written off on a straight-line basis over thirty-five years; and (d) record a direct credit of $ 12.75 million to its regulatory capital and amortize this "capital credit" over thirty-five years. The agreement between Citizens and the government therefore gave Citizens the right to use $ 52.9 million of supervisory goodwill and capital credit for regulatory capital purposes.

At the time of the acquisition of First Federal and Gary, Citizens needed the supervisory goodwill and capital credit in order to meet its regulatory capital requirement. By late 1989, around the time that the Financial Institutions Reform, Recovery, and

Enforcement Act of 1989, Pub. L. No. 101-73, 103 Stat. 183 (1989) ("FIRREA") was enacted, however, Citizens no longer needed to use the supervisory goodwill or capital credit to meet the then-applicable regulatory capital requirement. The Office of Thrift Supervisory ("OTS") 1989 examination report states that as of August 1989, Citizens had approximately $ 55.7 million in "regulatory capital," or 10 % of total assets. The "regulatory capital" included $ 30 million in the "supervisory goodwill" capital remaining from the 1983 assistance acquisition and $ 10 million remaining from the amortization of the $ 12.75 million "capital credit." By virtue of Citizens' successful management, it had tangible capital of $ 15.1 million or 2.7 % of assets.

Enactment and implementation of FIRREA led to changes in Citizens' ability to use supervisory goodwill and capital credit for regulatory capital purposes. At the time of FIRREA's implementation, Citizens had an unamortized balance of $ 38.5 million, which included $ 28.4 million of supervisory goodwill and $ 10.1 million of capital credit. Under FIRREA and its implementing regulations, the government required Citizens to deduct these amounts from its regulatory capital accounts on an accelerated basis and to eliminate them entirely by 1994. As a result, once FIRREA was implemented, Citizens' capital declined from over 10 % of assets to less than 5.5 % of assets.

II. Damage Theories

While it is not disputed that Citizens' loss of supervisory goodwill did not interfere with its ability to meet its regulatory capital requirements, n1 Citizens contends, through its expert, Dr. Paul M. Horvitz, that Citizens was, however, damaged by the loss of its

excess regulatory capital. In particular, Dr. Horvitz contends that Citizens was forced to forego both internal as well as external growth opportunities in order to rebuild its capital levels. Citizens' decision not to grow is reflected in its Investment Policies and Strategies document ("the Strategy") for 1990, which was adopted in August 1989, following enactment of FIRREA. The Strategy states:

> Sensible planning becomes... complicated by the apparent abrogation of the Association's contract with the FSLIC on goodwill accounting.
>
> Currently, the Association's primary goal is to maintain capital levels well above all regulatory and other methods of measurement. To accomplish this, all savings and lending products are priced to maintain adequate spreads for profitability and significant growth in assets. At the current time, a decrease in the deposit base is acceptable.

Pl.'s App. at 252. In keeping with this strategy, Citizens' contemporaneous business plans from the early 1990s reflect its decision to shrink loans by 3 % and to not grow deposits. Id. at 386. Citizens' business plans called for additional loan shrinkage in 1993 and 1994. Id. at 320.

Citizens also decided that it could not grow by acquisition during this period of low capital ratios. For example, Citizens' 1991 Corporate Overview stated: "A local institution willing to merge will be explored only if

there is no dilution of capital.. . . Historically, sales have brought serious diminishment of capital to acquiring institutions." Id. at 400-01. Citizens' decision not to grow by acquisition is also discussed in the OTS' 1992 examination of Citizens.

It is not disputed that by following its business strategy and plans, Citizens was able to achieve its goal of a 10 % capital level by 1993 and thereafter began to use its net earnings to leverage and grow. By 1995, Citizens had grown from its pre-FIRREA $ 550 million to more than $ 600 million in assets, and by 1997, Citizens approached $ 750 million in assets. Id. at 34. In 1997, Citizens agreed to acquire another thrift, Suburban Federal Savings. In 1998, Citizens converted to stock ownership. Citizens raised $ 178 million in its initial public offering. Id. at 289. Of the amount raised, Citizens used $ 45.5 million to acquire Suburban and incurred $ 8.9 million in merger expenses.

It is against this backdrop that Dr. Horvitz proposes several alternative damage calculations.

A. Expectancy Damages

Dr. Horvitz calculates expectancy damages under two approaches. First, under Dr. Horvitz' lost profit analysis, he concludes that Citizens would have leveraged its unamortized goodwill and capital credit and obtained an additional $ 20.9 million in profits over what Citizens otherwise obtained until 1998, when Citizens acquired Suburban and was able to achieve the size it would have reached absent FIRREA. Second, Dr. Horvitz also presents a cost of capital replacement analysis in which he asserts that had Citizens decided to replace its lost goodwill and capital credits, it would have cost Citizens $ 31.1 million to replace the $ 30.4

million of disallowed supervisory goodwill and capital credit remaining after FIRREA. Although Dr. Horvitz acknowledges that Citizens had elected not to replace the lost regulatory capital, he opines that if Citizens had done so it would have issued preferred stoek because preferred stock would have been the cheapest substitute.

The government challenges the assumptions and results of Dr. Horvitz' expectancy damage analysis with a report by Professors Bernard Black and Jeffrey Zwiebel. With respect to Dr. Horvitz' lost profits analysis, Professors Black and Zwiebel, taking into account various adjustments, conclude that the profits Citizens may have lost are those relating to additional assets that Citizens would have obtained had it been able to grow as planned. In this connection, Professors Black and Zwiebel state:

> We do not claim that Citizens would have earned a zero rate of return on incremental assets [i.e. those generated by additional growth]. . . . But our analysis shows how speculative and inflated Dr. Horvitz' estimates of lost accounting profits are. By making alternative and quite reasonable assumptions, we can almost completely eliminate these supposed lost profits.

Def.'s App. at 119.

In response to Dr. Horvitz' contention that it would have cost Citizens $ 31.1 million to replace its lost regulatory capital, Professors Black and Zwiebel claim that at the time of FIRREA, Citizens no longer needed supervisory goodwill nor capital credits to meet

Citizens' regulatory capital requirements and, therefore, "Citizens did not need to raise capital to be in regulatory compliance." Id. at 105. In such circumstances, Professors Black and Zwiebel contend that Citizens cannot make a claim for replacement capital. In the alternative, Professors Black and Zwiebel opine that to the extent Citizens replaced the lost regulatory capital, Citizens should only be entitled to its transaction costs or 6 % of the amount to be replaced ($ 30 million). Professors Black and Zwiebel calculate that the cost of replacing regulatory capital would be approximately $ 1.8 million. Id. at 80.

B. Restitution and Reliance

In the alternative, Dr. Horvitz posits that Citizens is entitled to restitution in the amount of $ 40.15 million, which is equal to the $ 52.9 million in liabilities Citizens acquired, less the $ 12.75 million in FSLIC cash assistance. Dr. Horvitz contends that this amount accurately measures the benefits conferred by Citizens on the government as a result of the contract. According to Dr. Horvitz, restitution may be properly measured by the amount of "liabilities" assumed and paid by Citizens. Dr. Horvitz contends that the benefit to the government can also be measured by the fact that it did not have to provide additional cash assistance to Citizens, because Citizens was willing to accept supervisory goodwill and capital credit in lieu of additional assistance. Dr. Horvitz calls this measure of restitution the Ruback/Heggestad approach, for the two academics Professor Richard Ruback of Harvard University and Professor Arnold Heggestad of the University of Florida, who have presented their model in other Winstar cases.

Dr. Horvitz also opines that Citizens is entitled to $ 40.15 million in reliance damages based on the same equation employed in calculating restitution damages. Dr. Horvitz argues this amount encompasses the net costs incurred by Citizens as a result of the contract and the government's breach. Dr. Horvitz further states that Citizens obtained no benefits from the its acquisition of First Federal and Gary and, therefore, Citizens is entitled to the full $ 40.15 million of liabilities it assumed and paid. Specifically, Dr. Horvitz concludes: "It is my opinion that the assets and liabilities Citizens acquired in the transaction generated net losses for years following the transaction, leading to a cumulative net loss by the time of the breach in 1989." Id. at 20.

Professors Black and Zwiebel challenge Dr. Horvitz' assumption that a rational investor would value $ 40 million in supervisory goodwill the same as $ 40 million in cash. They claim that the parties involved in the 1983 transaction focused on the $ 12.75 million cash assistance, acknowledging that the supervisory goodwill was worth much less than the cash. Professors Black and Zwiebel argue that Citizens only assumed the $ 40 million in liabilities because it expected to earn a profit by doing so: "If Citizens really believed that it was acquiring $ 40.15 million more in net liabilities than net assets, it must have believed that it was also acquiring an equal amount of other, perhaps intangible assets... ." Id. at 120-21. Professors Black and Zwiebel then go on to "roughly estimate" the net profit Citizens received from acquiring First Federal and Gary, which they conclude is between $ 40-45 million. Id. at 125. Based on this analysis, Professors Black and Zwiebel assert that Dr. Horvitz' restitution and reliance theory is unsupported because it is based on the "ridiculous

claim that Citizens got no benefit at all from the acquisition, and thus suffered a net $ 40 million loss." Id. at 126. Professors Black and Zwiebel also challenge Dr. Horvitz' contention that Citizens actually paid the $ 40 million in assumed liabilities. See id. at 731-47.

DISCUSSION

I. Standard of Review

Summary judgment is appropriate where there is "no genuine issue as to any material fact and . . . the moving party is entitled to judgment as a matter of law." *Rules of the United States Court of Federal Claims 56(c)*; *Golden Pac. Bancorp v. United States, 15 F.3d 1066, 1071 (Fed. Cir. 1994)*; *Mingus Constructors, Inc. v. United States, 812 F.2d 1387, 1390 (Fed. Cir. 1987)*. No genuine issue of material fact exists when a rational trier of fact could only arrive at one reasonable conclusion. See, e.g., *Matsushita Elec. Indus. Co. v. Zenith Radio Corp., 475 U.S. 574, 587, 89 L. Ed. 2d 538, 106 S. Ct. 1348 (1986)*. Thus, if the nonmoving party produces sufficient evidence to raise a question that would alter the outcome of the case, summary judgment must be denied. In making this determination, the court is mindful that any doubt over a factual issue must be resolved in favor of the nonmoving party. *Id. at 587-88*.

The party moving for summary judgment has the burden initially of pointing out the absence of any genuine disputes of material fact. *Celotex Corp. v. Catrett, 477 U.S. 317, 323, 91 L. Ed. 2d 265, 106 S. Ct. 2548 (1986)*. Once the movant discharges this burden, the non-movant must demonstrate specific facts showing a genuine dispute of fact for trial. *Matsushita*

Elec., 475 U.S. at 586-87; Dairyland Power Coop. v. United States, 16 F.3d 1197, 1202 (Fed. Cir. 1994). Thus, the nonmoving party must "go beyond the pleadings and by [its] own affidavits, or by the 'depositions, answers to interrogatories, and admissions on file,' designate 'specific facts showing that there is a genuine issue for trial.'" *Celotex Corp., 477 U.S. at 324*; see also *Lujan v. Nat'l Wildlife Fed., 497 U.S. 871, 888, 111 L. Ed. 2d 695, 110 S. Ct. 3177 (1990)* ("[The object of [*Rule 56(e)*] is not to replace conclusory allegations of the complaint . . . with conclusory allegations of an affidavit."); *Anderson v. Liberty Lobby, Inc., 477 U.S. 242, 249, 91 L. Ed. 2d 202, 106 S. Ct. 2505 (1986).* In this connection, the nonmoving party "must do more than simply show that there is some metaphysical doubt as to the material facts." *Matsushita Elec., 475 U.S. at 586.*

II. Restitution

The government contends that the Court of Appeals for the Federal Circuit's holdings in *LaSalle Talman Bank, FSB v. United States, 317 F.3d 1363 (Fed. Cir. 2003), Glendale Fed. Bank, FSB v. United States, 239 F.3d 1374 (Fed. Cir. 2001)* and *Cal. Fed. Bank, FSB v. United States, 245 F.3d 1342 (Fed. Cir. 2001)* dictate the dismissal of plaintiff's claim for restitution. The court agrees. In LaSalle Talman, the Federal Circuit rejected the precise argument that the plaintiffs make here. LaSalle argued that restitution could be properly measured by the liabilities it assumed as part of its acquisition of a failing institution because "Talman was obligated to pay the assumed liabilities as they became due and did so pay . . . before the breach." *LaSalle Talman, 317 F.3d at 1376.* The Federal Circuit nonetheless concluded that restitution based on these

"assumed liabilities" is not a valid measure of restitution, primarily because the accounting liabilities assumed by Talman did not provide the government with a tangible benefit, such as a cash infusion into the acquired institution. Thus, the Federal Circuit concluded:

> The calculation of restitution damages based on the treatment of assumed "goodwill" liabilities as a cost of performance was generally resolved in *Glendale, 239 F.3d at 1382-83*, where this court held that damages are not properly keyed to "a liability that was at most a paper calculation." Although the assumed liabilities are indeed an accounting cost, as LaSalle stresses, we agree with the Court of Federal Claims they are not a usable measure of either cost to the thrift or benefit to the government, and thus not an appropriate threshold for restitution damages. See also *Cal. Fed. Bank, 245 F.3d at 1351*.

317 F.3d at 1376.

Citizens' attempts to distinguish this case from LaSalle Talman are not persuasive. The principle of restitution is to return to the non-breaching party the benefit it conferred on the breaching party less any benefits received by the non-breaching party. See *Glendale, 239 F.3d at 1380-81*. While the government no doubt received some benefit from Citizens' agreement to acquire First Federal and Gary, the benefit is not equal to the amount of assumed liabilities. Indeed, it is impossible to determine the benefit to the government

from Citizens' assumption of First Federal and Gary's liabilities in that it was never certain that the government would ever have had to absorb those liabilities. First, it is not disputed that had Citizens decided not to acquire First Federal and Gary, other banks were likely to step in and acquire them. For example, the record demonstrates that Great American Bank was also interested in acquiring First Federal and Gary. n2 Thus, Citizens' assumption that without its intervention, First Federal and Gary would have been liquidated and the government would have had to pay the cost, is unsupported. Second, restitution based on assumed liabilities is not a viable measure because, contrary to Citizens' contentions, Citizens did not permanently relieve the government of its responsibility for the net liabilities of First Federal and Gary. The government's insurance fund remained contingently liable in the event Citizens failed. See *id. at 1382.*

In sum, restitution based on the amount of assumed net liabilities simply does not properly measure the benefit to the government in this case and has been consistently rejected, in similar cases, on summary judgment. See *Franklin Fed. Sav. Bank v. United States, 55 Fed. Cl. 108, 120 (2003)* (Court granted government summary judgment with respect to restitution claim in amount of net liabilities assumed, stating "the remedy of restitution is as ill-suited in this case as it was in Glendale."); *Fifth Third Bank of W. Ohio v. United States, 55 Fed. Cl. 223, 244-45 (2003)* (Court granted government summary judgment, finding that "Federal Circuit precedent is unwavering that restitution cannot be measured by aggregating the net liabilities of a failing thrift acquired in a supervisory

merger."). In these circumstances, Citizens' claim for restitution, which for the reasons set forth above, is not based on a useable measure, must be rejected. n3 The government is entitled to summary judgment on Citizens' claim for restitution.

III. Reliance Damages

The government argues that Citizens' claim for reliance damages, which is also based on the amount of net liabilities assumed, must also be dismissed as a matter of law. While the government acknowledges that reliance damages are available in Winstar cases, the government argues that Citizens' approach to reliance damages must be rejected as a matter of law. In particular, the government argues that under the Federal Circuit holding in Glendale, reliance damages must be based on "actual losses" and that assumed liabilities are not actual losses. The government further argues that in a recent decision, this court expressly rejected on summary judgment reliance claims based on "net liabilities assumed." See *Fifth Third, 55 Fed. Cl. at 245-46*. Finally, the government argues that Citizens' reliance claim is not factually supported. The government's experts, Professors Black and Zwiebel, calculate that Citizens did not sustain a loss in acquiring First Federal and Gary. To the contrary, they calculate that Citizens received a $ 40-45 million net profit from acquiring First Federal and Gary. n4

Citizens argues, in response, that the court should hold that reliance damages can be properly based on the amount of net liabilities assumed by the acquiring institution, less any benefit it received. According to Citizens, where as here, it is alleged that the assumption of liabilities was a real "economic cost" and

not simply a paper loss, Citizens must be given the opportunity to show that it sustained an actual loss when the breach occurred. While Citizens concedes that it is only entitled to its "net loss" and thus any loss must be offset by any benefit Citizens received from the acquisition of First Federal and Gary, it argues that the burden is on the government to establish the benefit Citizens received. Citizens contends that this court should not reject its reliance claim simply because there are issues of fact in dispute surrounding the amount of benefit Citizens received from acquiring First Federal and Gary.

Citizens contends that the court should deny summary judgment to the governments but instead grant Citizens partial summary judgment on its reliance claim. Citizens argues that under the facts of this case it is undisputed that Citizens assumed a real "economic cost," when it assumed the net liabilities of First Federal and Gary. Citizens asks that the court recognize that fact and then leave for trial the issue of "offsets," or benefits Citizens obtained from the acquisition. In particular, Citizens acknowledges that the court must resolve whether Citizens ultimately obtained a $ 40-45 million net profit from the acquisition of First Federal and Gary, as the government's experts contend, or obtained no benefit as Dr. Horvitz, contends. At argument, Citizens counsel explained that all of the profit Citizens obtained following the acquisition of First Federal and Gary was attributable to Citizens' assets prior to its acquisition of First Federal and Gary.

There is no doubt that the Federal Circuit has approved of reliance damages in Winstar cases. In *Glendale, 239 F.3d at 1383*, the Circuit stated that

reliance damages "provide a firmer and more rational basis than the alternative theories argued by the parties." It is also true that, in Glendale, reliance damages were not based on assumed liabilities but on specific costs incurred by the plaintiff as a result of the breach. This does not mean, however, that the Glendale factors are the only factors to consider in determining reliance damages. As this court recently explained in *Franklin Fed., 55 Fed Cl. at 120-21*, reliance damages may be based on the assumption of net liabilities in appropriate cases. Thus, if Citizens can establish that it incurred an actual economic cost when it assumed the net liabilities of First Federal and Gary, and that the cost was not completely offset by the benefit it received from acquiring First Federal and Gary, Citizens may be entitled to reliance damages. See Dan B. Dobbs, Dobbs on Remedies § 12.3(1) (2nd ed. 1993) ("The reliance damages recovery is a recovery for *net* reliance loss, so that the defendant is credited with any benefit the plaintiff receives from the expenditures in reliance."). n5

Given the material facts in dispute over whether Citizens actually paid First Federal and Gary's net liabilities and then whether the acquisition of First Federal and Gary resulted in a net loss or net benefit for Citizens, the court is precluded from granting summary judgment for either side at this time. Citizens' reliance damage claim will have to be resolved at trial. The government's motion for partial summary judgment on Citizens' reliance claim is denied and Citizens' motion for partial summary judgment on its reliance claim is denied.

IV. Expectancy Damages

The government also seeks summary judgment with regard to Citizens' claim for expectancy damages. As discussed above, Citizens' expert presented two methods for calculating Citizens' expectancy damages. Dr. Horvitz presented a cost of replacement capital model and then a lost profits model. Each will be examined in turn.

A. Cost of Replacement Capital

As set forth in his expert report, Dr. Horvitz concludes that, although Citizens did not replace the supervisory goodwill and capital credit it had received as part of the acquisition of First Federal and Gary, had Citizens elected to replace that capital, it would have cost Citizens $ 31.1 million. Dr. Horvitz acknowledges that this amount is larger than the $ 20.9 million of lost profits Dr. Horvitz calculated. At argument, Citizens' counsel explained that Citizens is not seeking $ 31.1 million. Rather, counsel explained that Dr. Horvitz' replacement capital calculation demonstrates that Citizens had correctly determined that it was not economically sound to replace the lost regulatory capital and that Citizens had properly elected to reach its capital goals by shrinking:

> Professor Horvitz says, [the cost of replacement capital] is $ 30 million. Lost profits in my model are $ 20 million. This supports the mitigation point, that the most cost-effective mitigation way was through forgoing growth. . . . They stood in place; they shrunk . . . . [Professor Horvitz] says, because this is $ 30 million, which is more than $ 20 million, what they did was the most cost effective mitigation approach, and

> damages are 20, not 30. Even under the cost to replace model, damages are still 20, the lost profits.

Tr. at 130-31.

Given the statements of counsel at argument, the court finds that the plaintiff's lost profit claim is the only viable claim. Where, as here, the claim for expectancy damages based on the cost of replacement capital exceeds the claim for lost profits, lost profits alone is the only appropriate expectancy claim.

The court's conclusion is consistent with holdings of several other courts that have rejected a hypothetical cost of replacement capital model, when, in fact, the thrift pursued another strategy. For example, the trial court in *LaSalle Talman Bank, FSB v. United States, 317 F.3d 1363* rejected a hypothetical replacement capital model stating: "It is particularly inappropriate to resort to a hypothetical and unreasonably expensive method of replacing capital when the record shows the actual method of mitigation chosen by [the thrift]. . . . Plaintiffs damages should be calculated on the basis of the actual means by which it filled its capital deficit." *45 Fed. Cl. 64, 103* (emphasis added), aff'd in part, vacated in part by *LaSalle Talman, 317 F.3d 1363*. On appeal, the Federal Circuit did not disturb the trial court's conclusion. *LaSalle Talman, 317 F.3d at 1375*. Similarly, in *Columbia First Bank, FSB v. United States, 54 Fed. Cl. 693, 699 (2002)*, the trial court rejected a hypothetical cost of replacement capital model that is virtually identical to the one proposed by Dr. Horvitz, stating:

> Both the breach and the economic conditions were the realities plaintiff faced and the decision to forego raising capital was a business decision designed to address both. In this case, plaintiff both behaved reasonably and did not incur the cost of replacing capital. Plaintiff may have been damaged, and even badly damaged, by the breach, but the damage was neither caused nor increased by mitigation costs, and the court sees no reason to use hypothetical mitigation costs as a measure of damages now.

The court reached this same result in *Franklin Fed., 55 Fed. Cl. at 138*, in which the court also rejected a cost of replacement model similar to the one presented in this case on summary judgment.

Finally, in Fifth Third, another similar cost of replacement model to that posited by Dr. Horvitz in this case was rejected by the court. In rejecting Fifth Third's claim for the hypothetical cost of replacement capital, the court stated: "The Court of Federal Claims has rejected the theory that models for preferred stock can be used to calculate the cost of replacement capital for goodwill lost through the enactment of FIRREA." *Fifth Third, 55 Fed. Cl. at 243.*

In keeping with this consistent line of cases, Citizens' claim for replacement capital as a measure of its expectancy damages is rejected. The defendant is therefore entitled to summary judgment on Citizens' claim for cost of replacement capital.

B. Lost Profits

The court now turns to Citizens' lost profit claim. The government acknowledges that "the Court of Federal Claims has 'struggled' with the issue of granting summary judgment with regard to lost profits claims in the Winstar cases." Def.'s April 11, 2003 Rep. Br. at 10. n6 Nonetheless, the government contends that summary judgment is appropriate here because Citizens has failed to identify with specificity how Citizens lost any profit following FIRREA. In particular, the government contends that to establish lost profits, Citizens had to show what specific investment opportunities were lost following implementation of FIRREA. See Def.'s May 16, 2003 Rep. Br. at 20 ("Citizens failed to present contemporaneous evidence concerning actual lost investment opportunities, summary judgment is . . . appropriate."). The government argues that the present case is similar to *Fifth Third, 55 Fed. Cl. at 242*, in which the court granted summary judgment to the government on the grounds that, absent evidence of "what investments plaintiff would have made or activities in which it would have engaged in a hypothetical world without FIRREA and with its competitors restored to the real-world banking environment," proof of damages was too remote to support a lost profits claim.

Citizens argues that the government is wrong on the facts and that Citizens did submit extensive contemporaneous evidence, including pre-breach and post-breach business plans, investment policies and strategies, other financial records, and internal government regulatory records, deposition testimony, expert analysis and testimony to how Citizens lost profits following enactment of FIRREA. Citizens

contends that the government is imposing an "absolute certainty" test on the measurement of damages that is not required. Citizens notes that in *Energy Capital Corp. v. United States, 302 F.3d 1314 (Fed. Cir. 2002).* the Federal Circuit plainly rejected an absolute certainty test. In Energy Capital, the Circuit stated, "certainty [of damages] is sufficient if the evidence adduced enables the court to make a fair and reasonable approximation of the damages. In circumstances such as these we may act upon probable and inferential as well as direct and positive proof." *Id. at 1329* (quoting *Locke v. United States, 283 F.2d 521, 524, 151 Ct. Cl. 262 (Ct. Cl. 1960)).* "Reasonable certainty," Citizens argues, is an inherently factual element that is not readily susceptible to summary disposition. See *Bluebonnet Sav. Bank, FSB v. United States, 266 F.3d 1348, 1356-57 (Fed. Cir. 2001)* (reversing trial court's post-trial denial of expectancy damages for failure to meet reasonable certainty test).

The court agrees with Citizens that the government is not entitled to summary judgment on the issue of lost profits. Contrary to the government's assertions, Citizens has identified evidence to show that the government's breach interrupted Citizens' plans to expand its traditional thrift business of raising retail deposits and investing in safe, mortgage-type assets and investment securities. Citizens' pre-FIRREA business plans indicated that it intended to increase growth of both assets and deposits. Citizens' business plans following enactment of FIRREA show that Citizens embarked on a program to rebuild its capital by foregoing deposit growth. See Pl.'s App. at 320, 386. Similarly, Citizens had to put on hold its plans for

external growth. For example, when asked, Professor Horvitz testified:

> Q. Doctor, are you aware of any growth opportunities that you believe Citizens had to pass up in the 1990s due to the loss of regulatory capital?
>
> A. Sure. There were - there were lots of - as I indicated, of [Resolution Trust Corporation ("RTC")] transactions available, which they would have been a logical and qualified buyer if they had the capital cushion that they wanted.

Id. at 740.

Dr. Horvitz' statement is confirmed in Citizens' 1991 Corporate Overview Statement, which states: "Mergers will be limited . . . . Although RTC acquisitions have been evaluated in the past, future explorations will be minimal. Historically, sales have brought serious diminishment of capital to acquiring institutions." Id. at 401. The OTS Examiners 1990 report further states: "Management is actively discussing purchasing another association, however, they do not want to adversely impact capital in any way." Id. at 636.

In these circumstances, this case is plainly distinguishable from *Fifth Third, 55 Fed. Cl. at 240-41*, in which the plaintiffs' expert in that case could not identify any opportunities for growth that were available and then lost by virtue of the breach caused by FIRREA. Here, Citizens has identified sufficient evidence to present genuine issues of material fact as to both the existence and amount of lost profits.

Accordingly, the government's motion for summary judgment regarding Citizens' claim for lost profits is denied.

CONCLUSION

In view of the foregoing, the government's June 4, 2002 motion for summary judgment as to restitution damages and cost of replacement capital is hereby **GRANTED**. However, because genuine issues of material facts exist as to the plaintiff's claim for reliance damages and lost profits, the government's June 4, 2002 motion for summary judgment as to reliance damages and lost profits is hereby **DENIED**. The plaintiff's August 2, 2002 cross-motion for partial summary judgment as to reliance damages is hereby **DENIED**.

The court will contact the parties before **Monday, July 7, 2003** to schedule a conference call during which the court will set the trial date and schedule pretrial submissions.

NANCY B. FIRESTONE

Judge

Footnotes

n1 It appears that the parties agree that Citizens had core capital of 5.36 % of assets at the end of the first quarter of 1990, compared to the regulatory requirement of 3 % Citizens had been so profitable that it had earned at least 1 % on assets each year from 1985-1992. Citizens' core capital increased to 6.48 % by the end of 1990; 7.76 % at the end of 1991; and 9.12 % by the end of 1992.

n2 The record reveals that prior to approving the Citizens' proposal to acquire First Federal and Gary, the Federal Home Loan Bank Board was also negotiating with Great American. See Pl.'s App. at 212-13; 229-30.

n3 Citizens also argues that restitution can be measured by the value to the government of not having to provide additional assistance to the transaction, based on the Ruback/Heggestad model. Citizens does not, however, offer any calculation or support for this theory. In any event, the Ruback/Heggestad model also must be rejected on the same grounds as Citizens' claim for restitution based on assumed liabilities. The purpose of restitution is to return the plaintiff to where it would have been before the contract. *Glendale, 239 F.3d at 1380-81.* Thus, restitution is designed to take from the breaching party the actual benefit the breaching party received from the non-breaching party. Whether the government would have had to provide more cash assistance in order to secure the acquisitions of First Federal and Gary is not known. The court cannot base a restitution award on pure speculation. *Id. at 1382.*

n4 As discussed in the statement of facts, Professors Black and Zwiebel stated that Citizens' net profit would equal the sum of "(a) the additional cash profit [Citizens] earned from the acquisition through year-end 1989 (estimated . . . at $ 15 million); plus (b) the present value at year-end 1989 of expected future cash profit from the acquisition, measured at the date of breach (estimated . . . to be at least $ 15 million); plus (c) FSLIC's initial $ 12.75 million cash assistance payment.

Summing these three items produces a crude estimate of net profit of $ 40-45 million ." Def.'s App. at 125.

n5 In addition, it is also generally recognized that reliance damages should not exceed plaintiff's expectancy interest. See Dobbs § 12.3(2) ("The plaintiff should not be better off by reason of breach than he would have been upon full performance."). Here, Citizens has claimed approximately $ 40 million in reliance damages and approximately $ 20 million in lost profits. Citizens' counsel conceded at oral argument that Citizens recognizes that its expectancy interest should serve as a "cap" on its reliance claim. Tr. at 98 ("I think damages would be limited by an expectancy award, the benefit of the bargain. So, the $ 20 million would make Citizens whole and that would be the limit on any reliance or restitution.").

n6 Following the Federal Circuit's ruling in Cal Fed, the Court of Federal Claims, in numerous Winstar-related cases, including *Citizens Fed. Bank, FSB v. United States, 52 Fed. Cl. 561 (2002), Columbia First Bank, 54 Fed. Cl. 693,* and *Franklin Fed. Sav., 55 Fed. Cl. 108* has denied summary judgment to the government on those Winstar-related plaintiffs' claims for lost profits.

No. 93-306C
UNITED STATES COURT OF FEDERAL CLAIMS

CITIZENS FINANCIAL SERVICES, FSB f/k/a CITIZENS FEDERAL SAVINGS and LOAN ASSOCIATION,
Plaintiff,

v.

THE UNITED STATES,
Defendant.

5/1/2002

ORDER

Pending before the Court is plaintiffs short-form motion for partial summary judgment on liability. Upon consideration of the documentation submitted with plaintiff's short-form notion, and defendant's admission regarding the existence of a contract and FIRREA's breach of that contract, plaintiff motion for partial summary judgment on liability is GRANTED.

In light of the parties' disagreement about the duration of the capital credit, the Court defers consideration of this issue pending further briefing by the parties at a later stage in the case. The parties are advised that the appeal in Coast *Federal Bank,FSB v. United States has* been dismissed. 31 Fed. Appx. 679, 2002 WL 398718 (Fed.Cir. 2002). The parties shall submit a Joint briefing schedule no later than Monday, May 6, 2002.

IT IS ORDERED.